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Supreme Court of the United States.

OCTOBER TERM, 1937.

No. 455.

FREDERICK S. DEITRICK, RECEIVER OF THE BOSTON-CONTINENTAL NATIONAL BANK, ET AL., *Petitioners*,

v.

STANDARD SURETY & CASUALTY COMPANY OF NEW YORK, *Respondent*

(AND SIX OTHER ACTIONS CONSOLIDATED THEREWITH).

BRIEF FOR STANDARD SURETY & CASUALTY COMPANY OF NEW YORK.

FREDERIC H. CHASE,
RAYMOND P. BALDWIN,
Attorneys for Respondent.

FRANK H. STEWART,
Of Counsel.

ALFRED O. CHURCHILL & SON, LAW PRINTERS, BOSTON.

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v.

STANDARD SURETY & CASUALTY COMPANY OF NEW YORK, *Respondent*

(AND SIX OTHER ACTIONS CONSOLIDATED THEREWITH).

BRIEF FOR STANDARD SURETY & CASUALTY COMPANY OF NEW YORK.

These cases come before this Court on certiorari from the Circuit Court of Appeals for the First Circuit.

OPINIONS BELOW.

The opinion of the United States District Court is not reported. It appears in the record at pages 139-141.

The opinion of the Circuit Court of Appeals for the First Circuit appears in the record at pages 281-288, and is reported in 90 F. (2d) 862.

The opinion of the Circuit Court of Appeals for the First Circuit denying a petition for rehearing appears in the record at pages 291-293, and is reported in 90 F. (2d)

862, 866. The order of this Court granting a writ of certiorari is reported in U.S. , 82 L. Ed. 102, 58 S. Ct. 143.

Statement of the Case.

The cases are concerned with four instruments purporting to be bonds of the Surety Company, and with certain other instruments purporting to be "endorsements" or extensions thereof. The suits in equity were brought by the Surety Company for cancellation of the instruments, and in those suits the Receiver made counter-claims on the instruments. The actions at law were brought by the Receiver on three of the instruments. The issues raised by the Receiver's counterclaims in the equity suits were identical with the issues in the actions on the bonds (R. 292, 293).

The cases were tried together before a single master and auditor. The major facts found by him, which were practically undisputed, are as follows:

Giving of the Bonds.

The Bank had made a loan to Cronin the soundness of which was open to question. Ragan, the president of the Bank, wanted to get Cronin's note guaranteed. No surety company would write a bond securing the loan without a premium and without security. Ragan approached Cliff, an agent of the Surety Company. Although Cliff had a broad power of attorney, Ragan knew that he had no authority to write the bonds here in question.

The Cronin bond and all of the subsequent bonds were written secretly by Cliff, purporting to act as agent of the Surety Company, at the request of Ragan, the president of the Bank. Each purported to guarantee payment of an obligation owing to the Bank. Cliff was an agent of the

Surety Company, and had a broad power of attorney. The Surety Company forbade his writing this type of bond; and denied to him authority to execute supplementary agreements, waivers, or acceptances of changes in contracts (R. 46, 47). Ragan knew that Cliff had no authority to write the bonds (R. 47).

Ragan induced Cliff to write the bonds by promising him that he (Ragan) would keep them in his personal file and use them only to show to the bank examiners if they asked to see collateral on the notes; that Cliff need not report the bonds to his Company or keep any record of them in his office; that no premium would be paid; that the bonds were simply "window dressing"; that they were valueless, imposed no liability and would not be enforced, and that they would be returned to Cliff shortly; and that Ragan would give Cliff a release, releasing the Surety Company from all liability on the bonds (R. 45-47).

In writing the bonds Cliff relied upon what Ragan said to him (R. 46, 47). As part of the same transaction in each case (R. 47), Ragan did give Cliff a release on each bond, running from the Bank to the Surety Company, and signed by Ragan as president of the Bank. Ragan immediately on receipt of each bond, without Cliff's knowledge, delivered it to the collateral department of the Bank. Cliff dealt only with Ragan; and Ragan acted alone in placing the bonds and "endorsements" in the files of the Bank, and in discounting the notes for which they were deposited as collateral, without the intervention of any independent officer of the Bank (R. 53). The Cronin (R. 45) and Stone (R. 50) obligations to the Bank were already outstanding when the bonds which purported to secure them were delivered by Cliff to Ragan.

Neither Cliff nor the Surety Company received any compensation or collateral for the bonds. Cliff kept no record of the transactions and did not report them to the Home

Office of the Surety Company. The Surety Company did not learn of the bonds until after the Receiver was appointed.

The Standard Surety Company was not negligent either in employing Cliff or in furnishing him with the power of attorney, stationery and seal (R. 54).

The Master and Auditor found that one Clark deposited $300,000 in the Bank in reliance upon its remaining open after an examination by the bank examiner, and upon a statement by Ragan to Clark's son that the debts here in question were secured by surety bonds of a company or companies unnamed. Neither Clark nor his son saw the bonds. Clark sued the Receiver to rescind the transaction on the ground, among others, that these bonds were fraudulent and uncollectible (*Clark* v. *Boston-Continental National Bank,* 9 F. Supp. 81, 83), and got a judgment, which has been satisfied.

There was no finding that the published statements of the Bank's condition would have been in any different form if the bonds had not existed, or that any depositor or other creditor relied on the published statements (R. 58). There is no affirmative finding that, but for the bonds, the Bank would have been closed sooner than it was (R. 59). There is no finding that the Bank was insolvent when the bonds were given.

There is no finding that any of the primary obligations to the Bank which the bonds purported to secure could not have been collected from the principals had the Bank attempted to enforce them as they matured.

Notice of Default.

In each of the four bonds there was a provision that, in the event of default on the part of the principal, the Bank should notify the Home Office of the Surety Company by

registered mail within ten days of such default (R. 73, 74, 93, 97, 99, 100).

The Master found that notice was not given on time in the case of the Stone and Robinson bonds.

The Cronin bond ran for six months from September 6, 1930. The first Cronin note matured September 22, 1930. As or after each note matured he gave a new note. There were sometimes intervals, one as long as sixty-three days, between maturity and new note (R. 78). The bond ran until March 6, 1931. There was no "endorsement" executed by Cliff until March 21, 1931, fifteen days after the expiration of the bond (R. 77). The Surety Company was first notified of default on November 4, 1932. The last of the series of Cronin notes matured on November 3, 1932 (R. 78).

As to the Westchester bond, the Master found that notice was not given in accordance with the terms of the bond, but may have been in accordance with one of the endorsements as construed by him (R. 79). But he had already found that the bond did not describe the obligation in question (R. 49), as a careful textual examination would have shown (R. 55), and had ruled that there was no liability upon the Westchester bond (R. 72).

Election of Remedies.

Before issue was joined in any of these seven cases, and before he brought suit in the law actions, the Receiver filed a sworn proof of loss against the Fidelity & Deposit Company of Maryland, under which he claimed a right to recover under certain banker's blanket bonds written by that Company, on the ground that the four bonds here in question were fraudulent and uncollectible. The Receiver later brought an action in the District Court against the Fidelity & Deposit Company on these blanket bonds, in which he

relied upon that proof of loss. Still insisting upon his claim, he entered into a compromise agreement with the Fidelity & Deposit Company, and that case went to judgment in his favor. That judgment has been satisfied (R. 81-88). The Surety Company was a re-insurer of the Fidelity & Deposit Company with reference to its obligations under these blanket bonds, as counsel for the Receiver knew before going to judgment in the action on the blanket bonds (R. 88).

Certain Objections to the Report of the Master and Auditor.

As to the facts, there are several statements in the Report, and findings and conclusions of fact, with which the Surety Company disagrees.

1. On page 3 of his Report (R. 43) the Master states that the Surety Company contends :

> (1) That the bonds were given by Cliff without authority and without consideration, as part of a fraudulent scheme of Cliff and Ragan, designed to deceive various persons, etc.

The Surety Company does not so contend, or rely upon any intent of Cliff's to deceive any one. Upon the evidence, the only person to whom Ragan told Cliff that he might show the bonds was the bank examiner (R. 45, 47, 50, 52).

2. The facts found by the Master in regard to Clark, and the evidence in regard to Clark, do not warrant the conclusion on page 23 of the Report (R. 58) where the Master says:

> "And I therefore conclude and find that Clark relied upon the existence of these bonds in investing $300,000. in the bank."

3. The facts found by the Master in regard to other depositors do not justify the Master's conclusion (R. 59) that depositors subsequent to the bank examination of September, 1931, relied upon the bonds; and the Master's attitude on the *questions of fact* in regard to reliance on the bonds by Clark and others ought not properly to be "influenced to some extent by the circumstances that the proof of reliance in this case seems more direct than in other reported cases" (R. 60).

4. On the evidence as set forth in the Report the Master could not find, as he purports to (R. 59), that depositors after September 5, 1931, "are still creditors of the bank in an amount exceeding the face value of the bonds" (see evidence reported in Exhibit H, Record, pp. 103, 104).

Introduction to Argument.

The Bank perpetrated a fraud upon the Surety Company in obtaining the bonds. The Receiver now seeks to enforce the bonds, so obtained, for the benefit of all the creditors of the Bank. He must take the bitter with the sweet, and cannot take the bonds without the burden of the fraud upon the Surety Company.

The bonds do not represent any asset of the Bank which would constitute a trust fund in the hands of the Surety Company. It is not claimed that they ever had or could have had any substance. The only question is whether the Surety Company is "estopped" to set up the fraud by which the bonds were obtained, namely, the fraud which Ragan induced Cliff to assist him in perpetrating upon his principal.

To accomplish such an "estoppel" the Receiver, as the "representative" of creditors, resorts to the ambiguous use of words. Citing an imposing array of state and fed-

eral cases, in not one of which is there any authority for holding the defrauded Surety Company in this case, the Receiver derives a general principle of public policy that one who participates in a fraud upon a bank examiner, by giving his note to the bank as an apparent asset, will not be heard to assert his own wrong as a defense on the note—which principle is frequently spoken of as an "estoppel" to set up the defense against the Receiver as the "representative" of the Bank's depositors.

As that "estoppel" obviously—and as expressly stated in some of the cases—would not "estop" an innocent party like the Surety Company here to set up as a defense the fraud practised upon it in this case, the Receiver tries to resort to a second "estoppel," based upon the principle that, where a principal has clothed his agent with apparent authority, the principal will be "estopped" to deny that authority as against any one who, in good faith, dealt with the agent in reliance thereon.

Cases asserting an estoppel against the innocent principal are of two kinds: cases in contract and cases in tort.

In the contract cases the principal may be estopped to deny the agent's authority as against any one who contracted with the agent relying in good faith upon the apparent authority. In the case at bar the other party to the contract is the Bank, not an innocent purchaser for value but a party itself chargeable with the fraud. The Receiver cannot, therefore, enforce the bonds as obligations of the Bank's which the Surety Company is estopped to deny. None of the Receiver's cases holds that he can.

In the tort cases the principal may be liable if, through the appearance of authority given to the agent, the latter, though acting against his principal's interest, has been enabled to deceive a person of a class to which the principal owed a special duty. In such cases the principal may be liable for damages to the person so deceived. The only

persons whom the Receiver here even claims were deceived to their injury were those individual creditors and depositors who put money into the Bank after the examiner had seen the bonds.

Even if the Surety Company had owed a special duty to those individual creditors and depositors (which it did not), and they had suffered definite and ascertainable damages in reliance upon the power of attorney (which has not been shown), any rights of recovery would be their individual rights, and not the right of the Receiver. Here again the cases are clear.

The Receiver, however, resorting to an ambiguous use of the word "represent," claims that he can assert the rights of these individual creditors and depositors because he "represents" the creditors and depositors of the insolvent bank.

If these individual creditors and depositors had any rights of recovery against the Surety Company which the Receiver can enforce, as distinct from a right of the Bank as the supposed obligee of the bonds, such causes of action were not pleaded. The cases were tried upon the pleadings, which were based upon the Receiver's claims upon the bonds as such.

It would be contrary to equity and good conscience for the Court to enforce against the defrauded Surety Company those bonds which came into the Receiver's hands through the fraud of the Bank's president, for which the Surety Company received nothing, and the proceeds of which, if they were enforced, would go in large proportion to creditors and depositors who by no stretch of the imagination can be said to have been deceived or injured by the power of attorney.

A desire for fundamental justice has led some courts, apparently, to cut through traditional precedent upon a broad rule of public policy and to hold a participant in

the wrong liable upon his promissory note given for the purpose of deceiving a bank examiner. It is doubtful that justice in any of the cases has called for a rule emancipated from the safeguards of legal principle. And however sound the application of such a rule of public policy may be in a case in which it is applied to hold liable one who is chargeable with the wrongful intent, the very sense of justice from which it springs should prevent it from becoming itself a traditional precedent to be applied, regardless of justice, in such a way as to make liable one who is ignorant that any obligation was ever given in his name, and is himself a victim of the fraud by which the bank obtained it. No case cited by the Receiver or found by counsel for the Surety Company has ever applied the principle in such a case.

The cases cited by the Receiver in support of his first "estoppel" are, almost without exception, concerned, not with actual injury to creditors and depositors, but with an intention to deceive the bank examiner. As the Surety Company here had no such intention, and, as will be shown, is not chargeable with any such intention, the Master and Auditor and the Receiver have both laid stress on actual deception of creditors and depositors. The Court is asked to rule that, where injury to depositors may be assumed, one who has made such assumed injury possible—the person who has, however blamelessly, allowed to come into the hands of the bank an instrument with which its fraudulent officer has practised a deception on the examiner—should be estopped to set up as a defense a fraud practised upon him by such bank or officer in obtaining or misusing the instrument.

One illustration alone should be enough to indicate the mischief to which such a doctrine would lead; Suppose that a man or woman were to place a negotiable bond, or an endorsed stock certificate, in the hands of a bank for a

perfectly proper purpose—as, for example, for safe keeping, or as excess collateral on a loan—and the bank's officers were, at the time of examination, to remove it from one place to another and were to show it to the bank examiner as an asset of the bank or as security for another obligation, and the deception were to cause injury to subsequent depositors. Under such circumstances the power to deceive given to the bank would be at least as great as any given by the Surety Company here. The likelihood of such misuse would be far more easily foreseeable. But to hold that in such a case the true owner would have to forfeit his bond or stock to the receiver for the benefit of all the creditors and depositors, who were not innocent purchasers for value, would impose a risk which has not been imposed in any case cited by the Receiver, and which would violate established principles of commercial dealings.

Academic interest in the questions which the petition for writ of certiorari attempts to raise tends to overshadow the other grounds of defense, either of which in an ordinary case should be sufficient in itself:

(1) The Receiver has brought one action in which he has gone to judgment and had his recovery upon his claim that these bonds were fraudulent and uncollectible, and in which he never abandoned that position until the judgment was satisfied.

(2) Even assuming that the bonds were valid obligations of the Surety Company, neither the Bank nor the Receiver gave the notice of default required by their terms.

Argument.

I.

The Bonds were Obtained by the Bank Through Fraud upon the Surety Company and are Void.

The fraud which clings to these bonds and renders them unenforceable against the Surety Company is not the fraud which Ragan practised upon the bank examiner; it is not the fraud which Ragan practised on Cliff; it is the fraud which Ragan practised upon the Surety Company, and by which the Bank obtained the bonds. The Surety Company does not have to rely upon the releases, or upon Ragan's false assurances to Cliff, which the Master found were parts of the same transaction (R. 47); nor need it rely upon the duress by which Ragan obtained all but the first bond (R. 49). It relies upon no act of Cliff as its agent. It simply repudiates the acts of Cliff in giving the bonds without authority, without apparent authority so far as the only obligor, the Bank, is concerned, and in fraud of the Surety Company, his principal.

A.

The Bonds were Obtained Through Fraud upon the Surety Company.

The Master and Auditor ruled as follows:

> "3. I rule that the bonds and 'endorsements' in suit were not binding obligations in the hands of the bank as a going concern, for the reason that Ragan's knowledge of their infirmities is imputed to the bank; and that the bonds and 'endorsement' would not be binding obligations in the hands of the receiver, if his rights were derived solely from the bank as distinguished from its creditors" (R. 61, 62).

This ruling was not excepted to by the Receiver in "Plaintiff's Exceptions to Auditor's Report" (R. 129, 130).

The decrees and judgments confirm the Master's ruling in this respect.

The judge of the District Court ruled as follows:

> "Upon these facts the bonds did not constitute valid obligations of the Standard Surety and Casualty Company and could not have been enforced by the Boston-Continental Bank" (R. 140).

The Circuit Court of Appeals ruled that, the taking of collateral for a loan being within the scope of Ragan's authority as president of the bank—

> "any notice to him of its illegality is notice to the bank" (R. 285).

Although counsel for the Receiver have not heretofore seriously contended that the Bank could recover on the bonds, it may make the scope of the subsequent argument clearer if the position of the Surety Company on this point is stated here:

1. *The Surety Company gave Cliff no authority to write these bonds.*

> "Authority is the power of the agent to affect the legal relations of the principal by acts done in accordance with the principal's manifestations of consent to him."
>
> Restatement of the Law of Agency, § 7, Authority.
>
> 2 Corpus Juris Secundum, Agency, § 95.

The Master found (R. 46, 47) that the Surety Company had, by letter to Cliff, given to him with the power of attorney, denied him permission to execute note-guaranty bonds without prior authority from the home office in each specific instance, and had specifically denied him authority to execute "supplementary agreements, waivers, acceptances of changes in contracts," etc.

Cliff had, of course, no authority to write bonds without premiums, as these bonds were written (R. 47).

> "* * * any authority, howsoever broadly it may be expressed, is to be confined, in the absence of definite manifestations of a contrary intent, to the doing of such things as are incident and appertain to the business of the principal and to that part of such business entrusted to the agent's care and such as are undertaken for the benefit of the principal and the furtherance of his interests."
>
> 2 Corpus Juris Secundum, Agency, § 94.

Even Cliff's broad power of attorney could be used only in the business of his principal.

> "The authority of a general agent is not unlimited; it must necessarily be restrained to the transactions and concerns appurtenant to the business of the principal."
>
> *Odiorne* v. *Maxcy,* 13 Mass. 177, 181.

> "His authority under the power of attorney was not unlimited. It was necessarily restricted to transactions appurtenant to the business and designed for the benefit of the owner."
>
> *English* v. *English,* 229 Mass. 11, 13.

"Unless otherwise agreed, authority to act as agent includes only authority to act for the benefit of the principal."

Restatement of the Law of Agency, § 39.
Ebert v. *Haskell,* 217 Mass. 209, 211.
And see *Union Stock Yards* v. *Gillespie,* 137 U.S. 411, 423.
Hanrick v. *Patrick,* 119 U.S. 156.
Wadsworth v. *Adams,* 138 U.S. 380.
Quinn v. *Boston,* 195 Mass. 277.
Mead v. *Phoenix Ins. Co.,* 188 Mass. 124, 126.
Fay v. *Winchester,* 4 Met. 513, 517.

Cliff's acts in writing the bonds were not in pursuance of his agency, but in abandonment of it.

Thomson-Houston Electric Co. v. *Capitol Elec. Co.,* 65 Fed. 341, 343 (C.C.A. 6).
Wen Kroy R.C. v. *Pub. Nat. Bk. & Tr. Co.,* 260 N.Y. 84, 89.

2. So far as Ragan was concerned Cliff had no apparent authority to write the bonds.

As the Master found, it—

"Would have been obvious to anyone and was obvious to Ragan that Cliff [as he told Ragan] had no authority to do what he was doing, and that the bonds would not be reported to the home office. The writing of the bonds without premium was not within Cliff's apparent authority" (R. 47).

The Surety Company had given Cliff a broad power of attorney and had limited its scope by letter. A third per-

son, dealing in good faith with Cliff as the agent of the Surety Company, in the regular course of business, and seeing only the power of attorney, and being ignorant of any limitations on his authority, might be able to hold the Surety Company on a bond running to such third person and executed by Cliff in the name of the Company. But Ragan knew that Cliff had no authority to write the bonds (R. 47).

> "Private instructions or limitations are valid and operative as between principal and agent, authority for the purpose of determining their relations and the incidents thereof being the remainder left after subtracting from the total extent of the powers given whatever included matters may have been withdrawn or excepted from the general grant. Moreover, a third person dealing with an agent cannot disregard with impunity qualifications of this character which he does or should know, for, as is shown in § 92, non-secret limitations on, or restrictions of, the agent's powers are binding upon those who deal with him, having knowledge or notice of the limitations."
>
> 2 Corpus Juris Secundum, Agency, § 95.
> *Slocum* v. *New York Life Ins. Co.*, 228 U.S. 364.
> *Welch* v. *Hartford Fire Ins. Co.*, 73 N.Y. 5.
> *Marsh* v. *S.M.S. Co.*, 289 Mass. 302, 306, 307.
> *Howard* v. *Barnstable Nat. Bk.*, 197 N.E. 40, 43 (Mass. 1935).

(a) "If a third person has such information as would lead a reasonable man to believe that the agent is violating the orders of the principal or that the principal would not wish the agent to act under the conditions known to him, he cannot subject the principal to

liability. Any substantial departure from the usual methods of conducting business is ordinarily a sufficient warning of lack of authorization."

(b) "As stated in § 39, it is inferred that an agent has authority to act only for the principal's benefit. If, therefore, the third person has reason to believe that the agent is acting for his own benefit, he cannot subject the principal to liability upon a contract which is in fact unauthorized."

(c) "Where circumstances indicate that the agent may be acting in fraud of the principal, a person dealing with the agent is required to exercise care in investigation, in order to hold the principal liable."

Restatement of the Law of Agency, § 166, c. 6. See also §§ 49, 165, 273.

3. In obtaining the bonds Ragan was perpetrating a fraud upon the Surety Company.

Ragan persuaded Cliff to act in collusion with him and to write the bonds and endorsements which he knew Cliff had no authority to write. He knew and intended that Cliff should withhold all knowledge of the bonds from the Surety Company, contrary to Cliff's duty to his principal, and knew and intended that the Surety Company should receive no benefit from the transaction, no premium and no collateral, and that the bonds, if enforceable, would subject the Surety Company to heavy liability (R. 44-53).

This was a fraud upon the Surety Company of which Ragan, as its instigator, had knowledge.

Crocker v. *United States*, 240 U.S. 74, 81.
Slocum v. *N.Y. Life Ins. Co.*, 228 U.S. 364, 374 (*supra*).

Hoffman v. *Hancock Life Ins. Co.*, 92 U.S. 161.
Restatement of the Law of Contracts, § 471.
Pacific Lumber Co. v. *Moffat*, 134 Fed. 836, 838 (C.C.A. 8, 1905).
Washington, A. & Mt. V. Ry. Co. v. *Real Estate Trust Co.*, 177 Fed. 306, 311, 312.
Metropolitan Trust Co. v. *Federal Trust Co.*, 232 Mass. 363, 367.
3 Corpus Juris Secundum, Agency, § 280.
Restatement of the Law of Agency, §§ 180, a, 312-315.

B.

THE FRAUD IS IMPUTED TO THE BANK.

The Bank was represented in the transactions solely by Ragan (R. 53, 63). Ragan knew that Cliff had no authority to write the bonds (R. 47).

The Bank took the bonds charged with the fraud of Ragan, through whom it obtained them.

Curtis, Collins & Holbrook Co. v. *United States*, 262 U.S. 215, 222, 223.
United States v. *State National Bank of Boston*, 96 U.S. 30.
Mechanics Universal Joint Co. v. *Culhane*, 299 U.S. 51, 57.
Crocker v. *United States*, 240 U.S. 74, 81.
McIntyre v. *Pryor*, 173 U.S. 38, 52.
Veazie v. *Williams*, 8 How. 134, 137.
Aldrich, Receiver, v. *Chemical National Bank*, 176 U.S. 618.
Munroe v. *Harriman et al.*, 85 F. (2d) 493, 495 (C.C.A. 1, 1936; certiorari denied).

Bosworth v. *Maryland Cas. Co.*, 74 F. (2d) 519 (C.C.A. 7, 1935).

Porter v. *Beha*, 8 F. (2d) 65 (U.S. D.C. N.Y.).

Irving Trust Co. v. *State Bankers Financial Corp.*, 40 F. (2d) 90 (U.S. D.C. N.Y.).

Salter v. *Williams*, 244 F. 126, 156 (certiorari denied, 250 U.S. 653).

Skud v. *Tillinghast*, 195 Fed. 1.

Tremont Trust Co. v. *Noyes*, 246 Mass. 197, 207.

Chapple v. *Merchants Nat. Bank*, 284 Mass. 122, 137.

Merchants Nat. Bank v. *Marden Orth Co.*, 234 Mass. 161, 171.

Atlantic Cotton Mills v. *Indian Orchard Mills*, 147 Mass. 268, 275.

Loring v. *Brodie*, 134 Mass. 453, 457.

Skinner v. *Merchants Bank*, 4 Allen, 290.

Atlantic Bank v. *Merchants Bank*, 10 Gray, 532.

Metropolitan Trust Co. v. *Federal Trust Co.*, 232 Mass. 363, 367.

Wasserman v. *Cosmopolitan Trust Co.*, 252 Mass. 253.

Restatement of the Law of Agency, §§ 274, 282 (2), (c), Comment f, pp. 629, 631.

Clark v. *Reeder*, 158 U.S. 505.

Salterwhite v. *Harriman Nat. Bk.*, 13 F. Supp. 489.

Washington, A. & Mt. V. Ry. Co. v. *Real Estate Trust Co.*, 177 Fed. 306, 311, 312.

Maryland Casualty Co. of Baltimore, Md., v. *Queenan*, 89 F. (2d) 115.

Ragan's knowledge of Cliff's want of authority to write the bonds, and Ragan's fraud upon the Surety Company in obtaining them, are imputed to the Bank. Although

the Master so ruled (R. 61-65), and although neither Bank nor Receiver excepted to this ruling (R. 129, 130), and although the Receiver's counsel disclaimed the contention in oral argument in the District Court (R. 143), and the District Court likewise ruled that the Bank could not have enforced the bonds (R. 140), counsel for the Receiver have since taken the position that Ragan's knowledge cannot be imputed to the Bank, because, as they claim, Ragan was acting solely in his own interest and against the interest of the Bank and as the agent of Cliff.

That position is untenable. The Master and Auditor found not only that Ragan knew of the infirmities in the bonds and endorsements, but also that he alone acted for the Bank in obtaining them for the Bank.

> "Neither he [O'Donnell] nor any other officer or employee of the Bank except Ragan had anything to do with negotiating for the bonds or 'endorsements' here in question" (R. 53).

Ragan alone approved the loans for which they were deposited as collateral.

> "All of the loans and renewals were granted by Ragan without prior consultation with the directors" (R. 53).
>
> "In the case at bar the loans were granted by Ragan's sole authority" (R. 64).

Furthermore, the obtaining of the bonds by Ragan was for, and not against, the interests of the Bank. The Cronin note had already been discounted for a week before Ragan even talked with Cliff (R. 45). The Cronin bond was given two weeks after the discount of the note (R. 93). The discounting of the Westchester note does not appear to have caused any withdrawal of funds from the Bank, the pro-

ceeds having been used to take up stock in the Bank (R. 49). (There is no contention that the Boston-Continental National Bank does not stand in the same position as the Continental National Bank with reference to the Surety Company (R. 44).) In any event, as the Master and Auditor has found, there was no evidence as to whether the four notes covered by the Westchester bond were ever signed or endorsed by the Westchester Discount Corporation or whether they were ever paid (R. 49). The Stone obligation had already been incurred before the Stone bond was given (R. 50). The Robinson bond was given before the Robinson note was discounted; but there is nothing to indicate that Ragan received any part of the proceeds of the Robinson note (R. 51, 52), or that Ragan intended the Robinson bond as a benefit to any one besides the Bank.

Even if Ragan had been acting adversely to the interests of the Bank in receiving the bonds, the Bank cannot now seek to profit by his act without being affected by his knowledge of the bonds' infirmities, particularly since Ragan was the sole agent through whom the bonds were obtained.

> "As stated by the American Law Institute, if the principal knowingly retains a benefit through the act of the agent which he would not otherwise have received, he is affected by the knowledge of the agent, although the agent was acting adversely.
>
> "A qualification of the rule that the knowledge of an agent engaged in an independent fraudulent act on his own account is not the knowledge of the principal has also been made when the agent, though engaged in perpetrating an independent fraudulent act on his own account, is the sole representative of the principal. It is held under such circumstances that the agent's knowledge is imputable to his principal, and that the

case falls within the general rule imputing the agent's knowledge to the principal."

2 American Jurisprudence, p. 300, Agency, § 380.

In *Curtis, Collins & Holbrook* v. *United States,* 262 U.S. 215 (*supra*), the company had paid for lands obtained for it by Holbrook, who made a profit on each transaction. This Court held the company chargeable with the fraud in the patents known to Holbrook, and said (by Taft, C.J., at p. 222):

"Under these circumstances, we do not think the company can be treated as a bona fide purchaser. It was charged with Holbrook's knowledge because he was the sole actor for the company in procuring the fraudulent patents * * *.

"The company and all its stockholders were charged with notice of any facts impairing the titles, of which in securing them, Holbrook was advised. In other words, the Company in taking over the titles took them *cum onere*" (citing *Atlantic Cotton Mills* v. *Indian Orchard Mills,* 147 Mass. 268).

Referring to *American National Bank* v. *Miller,* 229 U.S. 517, cited by the Receiver, the Court said:

"The president of the Macon bank was engaged in something in which his interest was plainly independent of any agency of his on behalf of the bank. His payment of his note was his own business, and not the bank's, as his principal. In the case at bar, Holbrook was the sole agent acting for the Company, he was violating his instructions; but he and the Company were in a common adventure, and if the Company insists on retaining the fruits of that adventure, it must be

charged with the knowledge of the agent through whom the fruits came."

In *Munroe* v. *Harriman*, 85 F. (2d) 493 (*supra*) (C.C.A. 1936; certiorari denied, 299 U.S. 443), Harriman had obtained loans from the bank of which he was president for a dummy corporation of his, and had pledged as collateral for the loans securities entrusted to him for another purpose. The Court held that the owner of the securities could recover them from the receiver of the bank, and said (by Swan, Cir. J.):

> (P. 496) "His will alone caused the making of the loan and the acceptance of the collateral. Therefore he should be treated as the sole actor on behalf of the bank as fully as though he had physically placed the borrower's note and securities in the bank's vault and paid over the borrowed money without the knowledge of any other officer. In such case, as already pointed out, the corporation can claim title only by virtue of the sole actor's act and must accept it burdened with his knowledge of the defect in title. • • •" (The *Curtis* case is cited.)

The fact that Ragan may have been animated in part by a wish to avoid disclosure of past indiscretions did not make the deposit of the bonds any less a benefit to the Bank. In *Bosworth* v. *Maryland Casualty Company*, 74 F. (2d) 519 (*supra*) (C.C.A 7, 1935), Taylor, the president of the bank, had deposited as collateral to his personal account bonds of an estate of which he was trustee. It was held that the surety on his bond as trustee could recover the bonds from the bank's receiver. The Court said (p. 520):

> "The transaction was in no way detrimental to the bank and of no benefit to Taylor, except as it postponed his day of wrath • • •.

"We think the Court was quite justified in holding that Taylor as sole agent of the bank, received the bonds for the bank, and that his knowledge of the fraud was properly imputed to the bank." (The *Curtis* case is cited.)

In *Atlantic Cotton Mills* v. *Indian Orchard Mills,* 147 Mass. 268 (*supra*), the common treasurer of two corporations covered the deficit of one with checks of the other, drawn by himself as treasurer. The Court, in allowing a credit for the checks to the defrauded corporation in an accounting between the two corporations, said (p. 275):

"The important consideration is, how the plaintiff became possessed of the money; and it is apparent that it was through the act of no other person than of Gray himself. It is true that no officer of the plaintiff besides Gray knew of the fraudulent origin of these checks; but in the very transaction of receiving them the plaintiff was represented by Gray, and by him alone, and is bound by his knowledge.

"Want of knowledge [of fraud] cannot in the view of the law exist, when the party in the particular transaction is represented solely by one who has knowledge. The rule is general, that, if one who assumes to do an act which would be for the benefit of another, commits a fraud in so doing, and the person for whose benefit the fraud will enure seeks, after knowledge of the fraud, to avail himself of [that] act, and to retain the benefit of it, he must be held to adopt the whole act, fraud and all, and to be chargeable with the knowledge of it, so far at least as relates to his right to retain the benefit so secured."

In *Indian Head National Bank* v. *Clark,* 166 Mass. 27, relied upon by the Receiver, accommodation indorsers of

negotiable paper were held liable to the bank, whose cashier intended when discounting it to use it to defraud the bank. As pointed out by the Master (R. 64, 65), this case, so far as inconsistent with the doctrine of *Atlantic Cotton Mills* v. *Indian Orchard Mills* (*supra*), has been distinguished and limited by *Tremont Trust Co.* v. *Noyes,* 246 Mass. 197. And in *Chapple* v. *Merchants National Bank,* 284 Mass. 122, which reiterates the doctrine of the *Atlantic Cotton Mills* case, the Court recognized this by saying (p. 139):

> "*Tremont Trust Co.* v. *Noyes,* 246 Mass. 197, 207, distinguishing anything appearing *contra* in *Indian Head National Bank* v. *Clark* 166 Mass. 27."

In the *Chapple* case the Court said (p. 137):

> "These decisions rest upon the doctrine that when a corporation receives funds belonging to a third party through the hands of its officer acting in that capacity, who knows that the funds have been wrongfully obtained from the owner and no other officer know the facts, it does not acquire good title to the money against the true owner."
>
> *Chapple* v. *Merchants National Bank,* 284 Mass. 122, 137, and cases cited.

In *Tremont Trust Co.* v. *Noyes* (*supra*), the plaintiff had been closed by the Commissioner of Banks. In its hands was a note which the defendant had signed in blank and delivered to the treasurer of the plaintiff with instructions as to how to fill in the blanks. The note was filled in by the treasurer for nearly ten times the authorized amount. The Court held that the trust company in the hands of the Commissioner could not recover on the note. After stating the general rule that an agent's knowledge of fraud is imputed to his principal, and the exception to that rule where

the agent is engaged in an independent fraudulent act, the Court goes on (p. 207):

> "But that exception does not obtain when the transaction, so far as concerns the principal, is undertaken and consummated wholly by the faithless agent in the prosecution of his perfidious scheme without the innocent intervention of any other agent of the principal and the principal does not repudiate that scheme when informed of it but undertakes to avail himself of its fruits. When the assets of the principal are by the hand of the treacherous agent in the execution of the fraud exchanged for the new security, be it note or other thing of value, then the knowledge of the agent is imputed to the principal. If the faithless officer acts alone in discounting a note and misappropriates the proceeds, then the bank is bound by his knowledge of the circumstances under which he had obtained it from the defendants. A subsequent ratification by officers ignorant of the nature of the original transaction does not change its character. Under these circumstances another principle of law becomes operative, namely that where one undertakes to profit by the act of another as agent, he must adopt the act as a whole and take the bitter with the sweet. One cannot take the gains of a fraud without also bearing its burdens."

Both *Curtis, Collins & Holbrook Co.* v. *United States,* 262 U.S. 215 (*supra*), and *Atlantic Cotton Mills* v. *Indian Orchard Mills,* 147 Mass. 268 (*supra*), have been cited repeatedly by both federal and state courts in support of the principles here advanced.

As no other officer or employee had anything to do with negotiating for the bonds and "endorsements," and as all loans and renewals were granted by Ragan without prior consultation with the directors (R. 53), no events subse-

quent to the receipt of the bonds could relieve the Bank of the onus of Ragan's knowledge of the infirmities in the bonds. In *Skinner* v. *Merchants Bank,* 4 Allen, 290 (*supra*), the other officers of the bank saw and counted the money fraudulently obtained, yet the Court held (Hoar, J., p. 296)—

> "that money obtained by fraud and conspiracy, received by the bank through Hooper, a partaker in the fraud, without consideration, did not become the property of the bank; and that no transfer from one officer to another in the bank, for the purpose of counting and ascertaining what money the bank had, could change the property * * *."

And in *Loring* v. *Brodie,* 134 Mass. 453 (*supra*), it was said (p. 462):

> "While the same transaction continues, however its form may change, the knowledge or the duty which existed at the time of its inception is still attached to it. It must be held, therefore, that the bank knew that the bonds belonged to the trust, and it was a duty that it should inquire whether there was any authority to pledge them, which inquiry would have revealed the misuse made of them by Brodie."

In *United States* v. *State National Bank of Boston,* 96 U.S. 30 (*supra*), Hartwell was cashier of the Sub-Treasury at Boston. He had embezzled a large amount of money of the United States by lending it to Carter. The funds of the Sub-Treasury were to be examined. To tide Hartwell over the crisis Carter bought gold certificates from the Merchants National Bank and paid for them by his certified check on the State Bank. It was arranged between Carter and the State Bank that the bonds when delivered by the Merchants Bank should be taken to the Sub-Treasury and

be left there until the next day, and receipt for them was to be taken in the meanwhile. This was done. The receipt was taken in Carter's name and by him endorsed to the State Bank. The next day the receipt was presented and the Sub-Treasury refused to deliver the certificates. The State Bank sued the United States in the Court of Claims. The State Bank was ignorant of the fraud. *Held:* The State Bank could recover.

> "An action will lie whenever the defendant has received money which is the property of the plaintiff, and which the defendant is obliged by natural justice and equity to refund. The form of the indebtedness or the mode in which it was incurred is immaterial.
>
> "In these cases, and many others that might be cited, the rules of law applicable to individuals were applied to the United States. Here the basis of the liability insisted upon is an implied contract by which they might well become bound in virtue of their corporate character. Their sovereignty is in nowise involved. *Atlantic Bank* v. *Merchants Bank,* 10 Gray 532 and *Skinner* v. *Bank,* 4 Allen 290, are, in their facts, strikingly like the case before us, and they involved the same point. It was held in each of those cases, after an elaborate examination of the subject, that the defrauded bank was entitled to recover.
>
> "But surely it ought to require neither argument nor authority to support the proposition that, where the money or property of an innocent person has gone into the coffers of the nation by means of a fraud to which its agent was a party, such money or property cannot be held by the United States against the claim of the wronged and injured party.
>
> "The agent was agent for no such purpose. His doings were vitiated by the underlying dishonesty, and could confer no rights upon his principal."

A review of the cases will be found in the annotations to *Gordon* v. *Continental Casualty Co.*, 319 Pa. 555, reported in 104 A.L.R. 1238. In that case the Court said:

> "It is argued by appellant's counsel, and we think convincingly, that the adverse interest exception to the rule that knowledge of a corporate officer is knowledge of the corporation applies only when a third person seeks to enforce some demand against the corporation, but the exception has no application where the corporation seeks to enforce the benefit of a fraud perpetrated by the officer on a third person; that the exception to the rule of imputed knowledge is not a vehicle for the consummation of fraud."

As the Bank must trace its title through Ragan's act, it cannot recover, because there is imputed to it Ragan's knowledge of Cliff's want of authority, and Ragan's fraud upon the Surety Company. These two defenses are open to the Company, not only as against the Bank, but also against any one whose claim of interest comes through the Bank. Furthermore, neither of these defenses requires reliance by the Surety Company upon Cliff's agency, so as to give any excuse for imputing to the Surety Company any knowledge or intention of Cliff's. They are based upon Cliff's want of authority and the fraud upon his principal, and knowledge thereof by the only person with whom he dealt as representing the only obligee of the bonds, the Bank. Any one who seeks recovery on the bonds without being barred by these defenses must show that he has a good ground of recovery aside from the facts of the direct transaction between Cliff and Ragan; that he has been misled by an act of the Surety Company itself—which is to say, by the power of attorney.

Cliff's knowledge cannot be imputed to the Surety Company so as to deprive it of its defense.

"A principal may avoid liability on any contract made by his agent in his behalf where there was fraud or collusion with the third person. * * *"

3 Corpus Juris Secundum, p. 183, Agency, § 252.

The Surety Company, unlike the Receiver, does not affirm the fraudulent transactions and seek to accept their fruits. Reliance on Cliff's acts, therefore, is not necessary to its defense, and Cliff's knowledge while engaged in the fraud is not imputed to the Surety Company.

Crocker v. *United States,* 240 U.S. 74; 60 L. Ed. 533.

"The presumption that the agent informed his principal of that which his duty and the interests of his principal required him to communicate does not arise where the agent acts or makes declarations not in execution of any duty that he owes to the principal, but to subserve simply his own personal ends or to commit some fraud against his principal. In such cases the principal is not bound by acts or declarations of the agent unless it be proved that he had at the time some notice of them, or, having received notice of them, failed to disavow what was assumed to be said and done in his behalf."

American Surety Co. v. *Pauly,* 170 U.S. 133, 156; 42 L. Ed. 977.

"The truth is that where an agent, though ostensibly acting in the business of the principal, is really committing a fraud, for his own benefit, he is acting outside the scope of his agency, and it would therefore be

most unjust to charge the principal with knowledge of it."

> Taft, J., in *Thomson-Houston Electric Co.* v. *Capitol Electric Co.*, 65 Fed. 341, 343 (C.C.A. 6); quoted in *Munroe* v. *Harriman*, 85 F. (2d) 493, 111 A.L.R. 657, 662.

A principal is not chargeable by implication with knowledge acquired by his agent when engaged in a scheme to defraud the principal, nor is he chargeable with constructive notice of the circumstances under which the agent acted in the prosecution of such scheme.

> *Henry* v. *Allen*, 151 N.Y. 1.
> *National Life Ins. Co. of the U.S.* v. *Minch*, 53 N.Y. 144.

And see Mechem on Agency (2d ed., 1914), § 1815.

> "The knowledge of its faithless agent is not imputed to the plaintiff as principal. The agent was conducting for his own benefit a fraudulent scheme against the interest of the plaintiff and therefore could not in that particular act for the plaintiff."
>
> *J. C. Penney Co., Inc.*, v. *Schulte Real Estate Co., Inc.*, Mass. 1935 Advance Sheets, pp. 2011, 2013.

C.

The Receiver Takes the Bonds Subject to Their Infirmity Arising Out of the Fraud upon the Surety Company.

The Receiver asserts that—

> "the Surety Company's defense rests upon the astounding proposition that the depositors and other

> creditors of a national bank may be despoiled by a conspiracy • • • and that • • • the conspirator whose promissory obligation was the instrument of the fraud may escape liability by showing that the obligation was not supported by any consideration moving from the bank or to the promissor or that the faithless bank official agreed, purportedly on behalf of the bank, that the obligation would not be enforced. • • •"
> (Petitioner's Brief, pp. 59, 60).

It is in refutation of this proposition that the Receiver has cited the long list of state cases on which he relies. But this is not the proposition on which the Surety Company relies; and the Receiver's cases, even if they support his view, do not apply.

The position of the Surety Company is that it is not a conspirator, but one conspired against. It relies neither upon want of consideration nor the promise of the faithless bank official as such, but upon the fraud practised upon it by procuring its agent to issue the bonds without authority and against its interest.

1. The Receiver, in attempting to enforce the bonds as assets of the Bank, stands in the shoes of the Bank.

a. The statute gives to the receiver of a national banking association the power to collect only the assets belonging to the bank.

Congress created the office of receiver of a national bank and defined his duties. He is appointed by the Comptroller of the Currency under the provisions of 12 U.S.C. § 191, 192 (June 30, 1876, c. 156, § 1, 19 Stat. 63; R.S. § 5234, May 15, 1916, c. 121, 39 Stat. 121). In defining his duties § 192 provides that he—

> "• • • under the direction of the comptroller, shall take possession of the books, records, and *assets* of

every description *of such association,* collect all *debts* due, and *claims belonging to it* * * *." (Italics supplied.)

Except for specific additional statutory powers, as, for example, the power to recover stock assessments (12 U.S.C. § 191), the receiver of a national bank is limited, in his collecting, to assets, debts and claims *belonging to the bank.* As the Court said in *Wallace* v. *Hood,* 89 Fed. 11, 22; 97 Fed. 983; 182 U.S. 555:

> "The receiver is the mere ministerial agent and instrument of the comptroller of the currency for winding up the affairs of the bank, with only limited powers, specified by the statute creating his office."

As this Court said in *United States* v. *Weitzel,* 246 U.S. 533, 541:

> "The appointment of a receiver does not dissolve the corporation; the assets remain its property; the receiver deals with the assets and protects them for whom it may concern, including the stockholders."

He is a "statutory assignee."

Kennedy v. *Gibson,* 8 Wall. 498.

In *Earle* v. *Commonwealth of Pennsylvania,* 178 U.S. 449, the Court said (at p. 455):

> "The scheme of the statute relating to suspended national banks is that from the time of a bank's suspension all its assets, of whatever kind, *as they are at the time of suspension,* pass in the first instance, to the receiver, the proceeds thereof to be distributed by the Comptroller among those whose claims are proved to

his satisfaction or are adjudicated by some court of competent jurisdiction."

See also *Folsom* v. *Smith,* 113 Me. 83, where the Court said (p. 92):

> "No special authority [under the statute] is expressly given a receiver to preserve or enforce the rights of creditors, as separate and distinct from the rights of the corporation * * *.
>
> "But the current of authority favors the proposition that a statutory receiver succeeds only to the rights of the defendant in the receivership suit, and is subject to all the equities that could have been successfully involved against the latter, unless the statute otherwise provides * * *."

b. The receiver of a national bank takes the assets of the bank subject to all equities.

In the leading case of *Scott* v. *Armstrong,* 146 U.S. 499, 507, the Court held:

> "The receiver took the assets of the Fidelity (National) Bank as a mere trustee for creditors, and not for value and without notice, and, *in the absence of statute to the contrary, subject to all claims and defenses* that might have been interposed as against the insolvent corporation before the liens of the United States and of the general creditors attached." (Italics supplied.)

In *Fourth St. National Bank* v. *Yardley,* 165 U.S. 634, 653, the Court said:

> "The receiver took no greater rights in the property of the insolvent bank which came into his possession than that which the insolvent bank possessed."

In *Rankin, Receiver* v. *City National Bank,* 208 U.S. 541, 546, the Court said, by Mr. Justice Holmes:

> "If the Guthrie [National] Bank had sued while it was a going concern, it could not have recovered, and *the receiver stands no better than the bank.*" (Italics supplied.)

2. The decisions under which recovery of assets of the bank has been allowed to a receiver when the bank itself might not have been allowed to recover have no application in the cases at bar.

The cases cited by the Receiver (Petitioner's Brief, pp. 24-26) for the proposition that a receiver of a national bank is not in all cases subject to defenses which would have been good against the bank are all cases in which the Court has kept the receiver within his statutory powers.

In the first, *Texas & Pacific Railway Co.* v. *Pottorff, Receiver,* 291 U.S. 245, 260, the Court held that "The bank itself could have set aside this transaction" (an *ultra vires* pledge of assets of the bank as security for a private deposit). But, added Mr. Justice Brandeis, even if the bank would have been estopped from asserting lack of power, its receiver would be free to challenge the validity of the pledge, because—

> "It is the duty of the receiver of an insolvent corporation to take steps to *set aside* transactions which fraudulently or illegally reduce the assets available for general creditors. * * *" (Italics supplied.)

The decisions in the *Pottorff* cases, and in *City of Marion* v. *Sneeden, Receiver,* 291 U.S. 262, immediately following it and also cited by the Receiver, are, it is submitted, cases in which the receiver is collecting assets of the bank. The

pledge of the securities was, in each case, void under the principles of the Statutes of Elizabeth (Acts of the 13th and 27th of Elizabeth), which, as this Court has said, were only declaratory of the common law.

Hamilton v. *Russell,* 1 Cranch, 309, 316.

As said by Shaw, C.J., in *Pratt* v. *Wheeler,* 6 Gray, 520, 522, 523:

> "The theory of the law is, that such a deed by a debtor, to defraud creditors, passes nothing; for all purposes of attachment, the estate is the property of the debtor, it is attached as his, levied upon as his, the title by force of the levy passes directly from the debtor to the execution creditor, the intermediate deed is void, and therefore the estate is not misdescribed as the estate of the debtor, though such void deed be on record."

These are different from the cases at bar, where the fraudulent transaction was not the void attempt to transfer away an existing asset of the debtor, but a void attempt on behalf of the debtor bank to acquire for it an asset which it had never owned.

The next three cases cited by the Receiver, *Scott* v. *Deweese, Receiver,* 181 U.S. 202, *Langtry* v. *Wallace, Receiver,* 182 U.S. 536, and *Oppenheimer* v. *Harriman National Bank & Trust Co.,* 301 U.S. 206, are concerned, not with the receiver's collection of assets of the bank, but with his separate statutory duty to collect stock assessments, which are, by statute, an absolute liability. In *Scott* v. *Deweese* the Court held that—

> "immediately upon the failure of the bank the rights of creditors attached under § 5151, and a shareholder who was such when the failure occurred could not es-

cape the individual liability prescribed by that section * * *."

The same decisions in the other two cases are based upon similar construction of the statute. In the *Oppenheimer* case, after the stockholder's statutory liability had been satisfied, the Court, holding that he could rescind the fraudulent sale of the stock to him as against the Conservator, said (p. 214):

> "Neither lapse of time while plaintiff remained ignorant of the fraud nor insolvency of the bank detracted from its liability."

In *McCandless* v. *Furlaud et al.*, 296 U.S. 140, the last case cited by the Receiver on this point, no national bank receiver was involved. The case is one of fiduciaries fraudulently depleting the assets of a business corporation. The principle of the Statutes of Elizabeth is applied, the majority opinion, delivered by Mr. Justice Cardozo, saying (at p. 167):

> "As we have striven to make clear, the receiver does not claim to succeed to the rights of bondholders and noteholders to recover damages for deceit. The wrong that is here redressed is the unlawful *depletion* of the assets whereby the company was made insolvent and the creditors were defrauded of their lawful remedies."

In the course of the dissenting opinion in that case, in which four Justices of this Court joined, Mr. Justice Roberts said (at p. 173):

> "Third. It is of course true that a receiver represents creditors and stockholders; but the proposition is true only in the sense that what he recovers as assets of his

> corporation is dedicated first to the payment of creditors and afterwards to the liquidation of outstanding shares. It has never been doubted that his right of action for a fraud committed upon the corporation by a third person is no greater than and no different from that available to the corporation * * *."

Even under the principle of the Statutes of Elizabeth, a fraudulent conveyance will not be set aside as against one who has taken for value and without notice of the fraud.

> *Horbach* v. *Hill,* 112 U.S. 144, 148.
> *Gottlieb* v. *Thatcher,* 151 U.S. 270, 279.

No public policy requires that an innocent person be penalized.

3. The decisions cited by the Receiver as having allowed receivers of banks to recover when the instrument has been given to make a false show of assets to deceive a bank examiner are not in point.

A careful examination of these decisions will reveal that all, at least all that support the Receiver, are based upon public policy, not upon estoppel. Some use the language of estoppel; but they are concerned, not with actual reliance by creditors, but with the intent to deceive the bank examiner. They consider it unconscionable that one guilty of wrong should set up his own wrong as a defense.

But there is no public policy against allowing an innocent person to defend himself against the fraud of another; nor is it unconscionable for him to do so. And *there is no case, state or federal, cited by the Receiver or discovered by counsel for the Surety Company, in which a receiver of a bank, state or national, has been permitted to recover*

against a party who, like the Surety Company in this case, had no knowledge of the transaction and was itself the victim of fraud.

The basic rule that one shall not be heard in a court of justice to allege his own wrong is not inconsistent with this Court's decision in the *Rankin* case. It is not a rule of estoppel. That rule is stated by an eminent writer as follows:

> "§ 426. Before concluding this Chapter, it is perhaps proper to take some notice of the rule of conduct which the judiciary has adopted for its own guidance, and in the public interest, that any party litigant shall not be allowed, either in support of his claim, or in answer to that of his opponent, to set up his own fraud, illegality or wrong—*nemo allegans suam turpitudinem est audiendus,*—a rule which is kin to, but of wider scope than, the rule, *ex turpi causa non oritur actio.* This principle is certainly not part of the doctrine of estoppel by representation: nor, indeed, in strictness can it be described as a rule of estoppel of any kind, even in the widest sense assigned to that term in jurisprudence * * *."
>
> Spencer Bower, The Law Relating to Estoppel by Representation (1923), pp. 383, 384.

The Surety Company in the cases at bar not only does not set up as a defense any fraud, illegality or wrong of its own; it is guilty of none. It is a victim of the fraud of others.

The State Court Decisions cited by the Receiver:

In many of the state cases the intent to deceive the bank examiner is not, of course, specifically alleged as a defense

to a note given for that purpose. The defense pleaded is want of consideration. Where the note was given for the accommodation of some one other than the bank, the defense of no consideration fails as against the bank. Where the note was given as an accommodation to the bank, the defense of want of consideration without more has been denied, apparently on the assumption that it is in itself an admission of a dishonest purpose to say that one gave a note to a bank which one intended not to pay. In one of the earlier and most frequently cited of the state cases, *State Bank of Moore* v. *Forsyth,* 41 Mont. 249, the Court said:

> "Notes are ordinarily given to a bank for the purpose of borrowing money therefrom. We can conceive of no circumstances under which a bank can acquire an accommodation note on its own account for any legitimate purpose. It seems to us that the mere request carries notice that the purpose for which such paper is intended is to be used is not a lawful one. What legitimate end could possibly be served by carrying in a bank commercial paper which was not to be paid under any circumstances? Obviously none. The only possible design would be to deceive some one, either the stockholders, the depositors, or the bank examiner, who acts for them in the name of the state. The trial judge should have held the defense of no consideration, unavailing under the defendant's own showing and should have given binding instructions for the plaintiff.

This language is quoted in *Bangor Trust Co.* v. *Christine,* 297 Pa. 64, 68 (which is itself cited in *Warren National Bank* v. *Jamieson,* 301 Pa. 45).

Comment on certain other specific cases may be helpful to an understanding of their views.

In *Day* v. *Farmers' & Merchants' Bank,* 229 Ala. 372, the remarks of the Court are *obiter dicta,* and refer to the "estoppel" as "consonant with the spirit of morality, common honesty and justice." Recovery by the receiver was denied because there was no averment that the note was executed for the purpose of making an appearance of assets so as to deceive the bank examiner.

In *Murphy* v. *Gumaer,* 18 Col. App. 183, the defendant said that the release of the overdrafts, which his notes were given to replace, was fictitious, and that there was no consideration. It appeared that the defendant knew the exact purpose for which the notes were used. The Court said (p. 189):

> "We do not think he is in a position to say that the books did not speak the truth."

In *Ashley* v. *Rowe,* 101 Fla. 110, the owner of bonds brought a bill to recover them from the receiver of a state bank. She set forth her agreement with the bank. In sustaining a demurrer to the bill, the Court held that she had connived in making an appearance of false assets, and said that it would be "unconscionable" for her to recover them. There was a dissenting opinion. The case was distinguished in *Mayer* v. *Eastwood Smith & Co.,* 122 Fla. 40, 45.

In *Golden* v. *Cervanka,* 278 Ill. 409, 427, actual cash once in the hands of a state bank was recovered by the receiver as "the restoration of a trust fund for the benefit of creditors." There are two dissenting opinions.

In *Niblack* v. *Farley,* 286 Ill. 536, the Court held that "It would be contrary to public policy and good morals" to permit the defendant to take advantage of a fraudulent agreement with the bank, by which, according to his own statement, he gave his note to enable the bank to deceive the bank examiner. The Court cited and distinguished *McCourt*

v. *Jacobs,* 256 Ill. App. 141, where the receiver was not allowed a recovery, the Court saying (p. 146):

> "No proof was offered tending to show that the note was given for any fraudulent purpose * * *."
>
> "There was no consideration for the note and it not appearing that the note was given for any illegal or fraudulent purpose, the judgment * * * is affirmed."

In *German-American State Bank* v. *Watson,* 99 Kan. 686, the defense was want of consideration. The Court held there was good consideration.

In *Cedar State Bank* v. *Olsen,* 116 Kan. 320, the Court held that the defendant was "estopped" to assert a secret understanding.

In *Hayes* v. *Addy,* 139 Kan. 481, the defendant pleaded accommodation and testified that he gave the note to deceive the bank examiner.

In *Bell* v. *Johnson,* 142 Kan. 360, the plaintiff sued the receiver of a state bank to recover a loan made to the bank. The Court, in sustaining a demurrer to his evidence, said (p. 366):

> "In the instant case, there was no witness save the plaintiff, and his testimony plainly showed that the purpose of removing Item 3 and putting in the money which it represented was for the purpose of deceiving the bank examiner * * *."

In *Denny, Banking Com'r,* v. *Fishter,* 238 Ky. 127, the defendant's second mortgage notes, on property which he received from the bank, were placed among the assets of the bank "as he knew would be the case." Estoppel was pleaded by the receiver. The Court held that the receiver could recover, saying (at p. 133):

> "Thus we see that, *under our statute,* the banking commissioner may maintain * * * such actions as a creditor or creditors could to collect in the assets liable for the bank's liabilities." (Italics supplied.)

In another Kentucky case, *The First National Bank of Nortonville* v. *Morton,* 146 Ky. 287, where the Court had denied recovery to a receiver of a national bank because it would there have been inequitable to hold the makers of a note given to make a show of assets, the Court (at p. 298) quoted the following language of Roscoe Pound, J., in *Home Fire Ins. Co.* v. *Barber,* 67 Neb. 645:

> "Because the inequitable conduct of Barber shocks the conscience of a Chancellor is no reason why he should give his conscience a further shock by allowing Finkhouser and his associates to recover money to which they have no legal or equitable claim * * *."

In *New* v. *Page,* 144 Md. 606, the Court held that notes given by directors of the bank for stock of the bank were given on good consideration.

In *Prudential Trust Co.* v. *Moore,* 245 Mass. 311, directors knowingly gave notes to make good depleted assets of their bank. It was held that, because of their position, there was good consideration, and that to let them plead invalidity of the notes would be "unjust and fraudulent."

In *German-American Fin. Corp.* v. *Merchants & Mfrs. State Bank,* 177 Minn. 529, the plaintiff, suing the receiver of a state bank for return of collateral on a note given to the bank, attempted to set up a secret agreement. Recovery was denied, the Court saying (p. 536):

> "The plaintiff, after entering into such a fraudulent scheme for the purpose of circumventing the law, cannot be permitted to escape liability."

Third National Bank of St. Louis v. *Reichert,* 101 Mo. App. 242, was an action by a national bank, not its receiver. The note was given to pay for stock in a company. The defendant maker set up an agreement that it was given so that the bank could exhibit assets to the bank examiner. The bank recovered, the Court saying (at p. 253):

> "a person who engages in a fraudulent transaction will be left without relief from a hurtful consequence which may befall him * * * there was good consideration for the note."

In *State Bank of Moore* v. *Forsyth,* 41 Mont. 249 (*supra*), the Court, which had said that one who gave an accommodation note to a bank, knowing that it is to pass through the regular channels of the bank, must know that it is for an illegal purpose, adds (at p. 271):

> "It is only an innocent party who can take advantage of such a defense * * *."

In *United States National Bank* v. *Chappel,* 71 Mont. 553, it was held that the Court in the *Forsyth* case had erred in excluding parol evidence of the agreement. Here the defendant gave her note to save her son from a charge of felony. Her note was used contrary to the agreement by which it was obtained. The Court said (p. 567):

> "The defendant here, *innocent of wrong,* was giving value for inaction and silence. None of the reasons which stopped the mouth of Forsyth confronted her upon her defense." (Italics supplied.)

Harrington v. *Connor,* 51 Neb. 214, was an action on a note purchased from the receiver of a state bank. The defense was "no consideration" and that the note was given for the sole purpose of enabling the cashier to get around

an excess loan statute. In allowing recovery the Court said (p. 219):

> "The defense which it was sought to interpose on behalf of the defendants *involved the statement of a fraud.* * * *" (Italics supplied.)

In *Schmidt* v. *Haines,* 115 N.J.L. 217, the defendant had endorsed a note payable to a national bank to help a company in which he was interested. The bank discounted the note. It was held that there was good consideration. The Court said (at p. 234):

> "Defendant's contention, in its essence, is that they became parties to the paper for the accommodation of the bank solely—an expedient devised to deceive the federal bank examiners * * *. There is respectable authority for the view that an accommodation party to a note given, as contended here, to deceive the bank examiner with a false finding as to the bank's assets, is estopped from asserting such defense, especially when insolvency intervenes. This estoppel is rooted in what has been termed '*good morals and sound public policy.*' " (Italics supplied.)

In *Hurd* v. *Kelly,* 78 N.Y. 588, it appeared from the defendant's answer that he was informed, when he executed the bond, that it was to be used in reference to the relations of the bank to the banking department "so that a better showing of assets of the bank would appear." It was held that it would be a "gross injustice" to permit him to avoid his obligation.

In *Best* v. *Thiel,* 79 N.Y. 15, a mortgage was given by the defendant to make up a deficit in the assets of the bank. It was held that, "upon the clearest principles of justice and morality, the defendant should be estopped from denying the validity of the mortgage."

Bay Parkway National Bank v. *Shalom*, 270 N.Y. 172, is another case in which the bank itself was allowed to recover on a note in spite of an agreement not to enforce it. The Court said (p. 176):

> "Where one knows that his note is to be treated as an asset of the bank and, as a result, bank examiners are deceived and depositors continue their accounts with the bank on the faith of the assumed solvency, then he is estopped from pleading the defense of no consideration."

Mount Vernon Trust Co. v. *Bergoff*, 272 N.Y. 192, decided in November, 1936, is the latest of the state cases cited by the Receiver. In that case the defendant at the request of the bank delivered her note to the bank and received back a letter saying that the note was not to be enforced against her "anything in said note to the contrary notwithstanding." The Court allowed the *bank* to recover. There was no question of insolvency. The Court said (pp. 195, 196):

> "In this case no witness, produced at the trial, testified as to the reason why a note was received, and at the same time a writing was given, exempting the maker from liability. No explanation is necessary, for but one inference can be drawn from the testimony. * * * The defendant may have been ignorant of what the bank was trying to conceal. *We are not told in this case whether the bank examiner was deceived, and indeed we do not know whether anyone was deceived.* A fictitious note delivered to a bank, intended to become part of its apparent assets, though not intended to be enforceable, is in itself a continuing falsehood calculated to deceive the public, and any person delivering such a note becomes a party to the falsehood.

> * * * The defendant may not have intended to deceive any person, but when she executed and delivered to the plaintiff bank an instrument in the form of a note, she was chargeable with knowledge that, for the accommodation of the bank, she was aiding the bank to conceal the actual transaction. *Public policy* requires that a person who, for the accommodation of the bank executes an instrument which is in form a binding obligation, should be *estopped from thereafter asserting* that simultaneously the parties agreed that the instrument should not be enforced." (Italics supplied.)

In *Vallely* v. *Devaney,* 49 N.D. 1107, notes were given to deceive the examiner. It was held (p. 1116) that the defendant was "estopped"—

> "When a note or other obligation is given to a bank with the avowed object of its appearing as assets for the purposes of public examination * * *."

In *Peterson* v. *Baird,* 63 N.D. 604, 605, the plaintiff was denied recovery where he alleged—

> "that on December 20, 1928, at the solicitation of the cashier of the bank, he assigned to the bank his interest in a contract for the sole purpose of restoring 'the cash reserve of said bank and thus avoid suspension of business' and for no other consideration."

The Court said (p. 612):

> "This estoppel arises when one silent 'when he ought to speak out, intentionally or through culpable negligence induces another to believe certain facts exist * * *.'"

In *State, ex rel. Lattamer,* v. *Hills,* 94 Ohio St. 171, the Court held that neither want of consideration nor failure

of consideration was a defense to a note given to meet the requirement of the State Superintendent of Banks, but added that, if the notes were given by a defendant to avert a threatened criminal prosecution against his brother if they were not given, the issue of duress was properly submitted to the jury. (*Cf.* Ragan's threats to Cliff after the first bond had been given, in order to obtain the others (R. 49).)

In *First National Bank* v. *Boxley,* 129 Okla. 159, the bank was allowed to recover, the Court saying (p. 163), that, where there was no want of consideration—

> "the maker cannot defeat its payment by showing that with his knowledge it was intended to mislead the bank examiner as to the bank's condition and securities."

Putnam v. *Chase,* 106 Ore. 440, 445, holds that, on grounds of "sound public policy," one who has executed a note for the express purpose of perpetrating a fraud shall not be heard to set up that fact as a defense.

In *State Bank of Pittsburg* v. *Kirk,* 216 Pa. 452, there was a rule absolute for judgment for want of a sufficient affidavit of defense in an action on a note. The affidavit of the defendant directors of the bank stated in part (p. 453):

> "The undersigned • • • hereby testify that the above-named notes are made up and carried by the bank in order to prevent having any past due paper • • •."

In *Lyons* v. *Benny,* 230 Pa. 117, the Court allowed the receiver to recover, saying (p. 121):

> "Neither the law nor good conscience can sanction the contention of the defendant that he ought to be permitted to take advantage of the fraudulent agreement between him and the bank • • •."

In *Arthur* v. *Brown,* 91 S.C. 316, the defendant gave his note to enable the bank to evade the law. The Court held (p. 322):

> "When he entered the plan * * * signed the note and had the bonds placed to his credit, as to the bank he was a maker for value."

Shaw v. *Borchers,* 46 S.W. (2d) 967 (Tex. Cir. App., 1932), was an action by the receiver of a state bank. The answer set up an agreement that the note would be listed as an apparent asset because of a requirement of the Commissioner of Banking, but would not become an obligation of the defendant. The Court held (p. 969):

> "Under the circumstances, fairness and justice demand that the defendant in error should be estopped from availing himself of the defense that the renewal note, which he led the banking department to believe to be a real asset of the bank, is but a mere scrap of paper."

In *West Rutland Trust Co.* v. *Houston,* 104 Vt. 204, the Court said (p. 208):

> "* * * it was an illegal transaction, and it is *against public policy to permit the defendants to rely upon such an illegality* as a defense." (Italics supplied.)

In *Webb* v. *Pleasants,* 144 Va. 516, the note was given for accommodation of the bank, as collateral for a certain note only. The note was not so recorded in the bank. It was held that the receiver could not recover. The Court said (pp. 519, 520):

> "It is of course true that as Pleasants was free from any complicity in the fraud practised by Pool, and was ignorant thereof, and as the note was a purely accom-

modation note for which Pleasants received no value whatsoever, as between the bank and Pleasants, unquestionably the bank would have no standing in court in an action against Pleasants to recover on the note.

"Under the facts in this case we do not think the receiver, suing for the benefit of the creditors of the bank, stands in any better position than the bank would stand. If Pleasants had been party to the fraud or if he had negligently done anything which kept the insolvent institution going to the detriment of depositors and creditors, the situation would have been different.

"That Pleasants had a right to give such a note to be used solely for the purpose for which this note was given, and which was void if used for any other purpose, and that such conditional delivery for such special purpose can be proven by parol, we think, is beyond question.

* * * * * * * *

"Under the circumstances of this case the receiver stood in no better position with reference to the note than the bank did."

Allen v. *Hay,* 64 Can. S.C. 76, though a Canadian case, is not announcing its own views of the law. The Court there said:

"even if our general notions as to the application of the rule of estoppel are violated in some respects we have to disregard those notions and apply the law as it is enunciated by the Washington [state] decisions."

None of the state cases appear to have discussed the statutory limits of the powers of the receiver of a national bank. Many of them use, in one form or another, the expression that "the defendant is *estopped* as against the

receiver who *represents* creditors and depositors of the insolvent bank." Few of them carry the "estoppel" beyond the initial intentional giving of the note. None of them holds liable a person who did not know that his note was to be used as an asset of the bank. None holds a maker liable without fault, because of any proved or assumed injury to specific creditors or depositors. None holds that the receiver "represents" specific creditors so as to utilize an injury to them for the benefit of all.

A careful reading of the cases cited by the Receiver will show, it is submitted, that the courts were not enforcing a right derived by the receivers of banks, whether state or national, from the creditors and depositors of those banks, but were applying a rule of disability to the makers of the notes who were guilty of fraud. They were, in effect, applying the rule of *nemo allegans suam turpitudinem est audiendus*, extended to include a prohibition against the makers' setting up the defense of accommodation to the bank where that defense is obviously an admission of participation in a misrepresentation by the bank of its assets.

This is borne out by the fact that, where occasion arose, the courts have applied the rule, not only on behalf of a receiver, but also on behalf of the bank itself. (See *Bay Parkway National Bank* v. *Shalom*, 270 N.Y. 172 (*supra*); *Mt. Vernon Trust Co.* v. *Bergoff*, 272 N.Y. 192 (*supra*); and *Warren National Bank* v. *Jamieson*, 301 Pa. 45 (*supra*).)

Some of the state courts for good measure, and some, perhaps, out of a confusion of mind arising out of the use of the word "estoppel," have mentioned actual deception of the bank examiner and continued business with depositors. Some courts in speaking of the receiver as "representing the rights of creditors" seem even to have borrowed the language of the law against fraudulent conveyances. But none of the decisions seeks to establish rights

derived through creditors and to let the receiver enforce them as such.

As has been seen, the principle of the Statute of 13 Elizabeth (2 St. at Large, p. 588) does not create an obligation which the debtor never owed. It rendered void a fraudulent conveyance and enables the receiver to treat the fraudulently conveyed property as the property of the debtor. And it does not even avoid a fraudulent conveyance against one who did not participate in the fraudulent intent.

The rule that no one will be heard to assert his own wrong, even if so extended as to prohibit his setting up accommodation to the bank, has no application to the Surety Company, which sets up no wrong and was guilty of none. Even a broad rule of public policy denying a defense to any one who participated in a deception of a bank examiner would not deny its defense to a party which, like the Surety Company, did not participate in any such deception.

The Federal Decisions:

Under the federal decisions the receiver stands in the shoes of the bank.

Rankin v. *City National Bank of Kansas City,* 208 U.S. 541; 52 L. Ed. 610.

Munroe v. *Harriman,* 85 F. (2d) 493 (C.C.A. 2, 1936).

Bosworth v. *Cady,* 72 F. (2d) 62 (C.C.A. 7, 1934).

Kaercher v. *Citizens' National Bank,* 57 F. (2d) 58 (C.C.A. 8, 1932).

Lenzing v. *Rayzor,* 41 F. (2d) 224 (C.C.A. 5, 1930).

Andresen v. *Kaercher,* 38 F. (2d) 462 (C.C.A. 8, 1930).

Hookway v. *First National Bank*, 36 F. (2d) 166 (C.C.A. 8, 1929).

Yates Center National Bank v. *Schaede*, 240 Fed. 241 (C.C.A. 8, 1915).

Skud v. *Tillinghast*, 195 Fed. 1 (C.C.A. 6, 1912).

Peterson v. *Tillinghast*, 192 Fed. 287 (C.C.A. 6, 1911).

Drake v. *Moore*, 14 F. Supp. 89 (D.C. E.D. Ill., 1936).

Varden v. *First Christian Church of Pineville, Ky.*, 13 F. Supp. 159 (D.C. E.D. Ky., 1936).

Stewart v. *Peoples-Ticonic Bank*, 12 F. Supp. 337 (D.C. Me., 1935).

Yates Center National Bank v. *Lauber*, 240 Fed. 237 (D.C. Kan., 1915).

Cutler v. *Fry*, 240 Fed. 238 (D.C. Kan., 1915).

Yates Center National Bank v. *Schaede*, 240 Fed. 240 (D.C. Kan., 1915).

The leading federal case, and the only case in which this Court appears to have expressed its opinion on the rights of the receiver of a national bank with respect to a fictitious asset which the bank itself could not recover, is *Rankin* v. *City National Bank of Kansas City*, 208 U.S. 541 (*supra*). In that case the defendant bank, which had set up a false credit on its books in favor of the insolvent national bank whose receiver brought the suit, was not called upon to set up its own fraud as a defense. It had already wiped out the credit in accordance with the secret agreement. That the Court had in mind the illegality of the transaction, and that it approved the rule *nemo allegans suam turpitudinem est audiendus*, is apparent from the statement of Mr. Justice Holmes (at p. 547):

> "In view of the statement of counsel • • • that they did not contend that the contract was illegal • • • we

shall not consider that aspect of the case. *It would not help the plaintiff. McMullen* v. *Hoffman,* 174 U.S. 639." (Italics supplied.)

For in the *McMullen* case the Court held that, in any action brought in which it is necessary to prove an illegal contract, courts will not enforce it; and that, where only part of the contract is pleaded, the other portions may be shown to have been illegal.

Had the Court felt obliged as a matter of public policy to penalize the City Bank for setting up the fictitious asset to deceive the bank examiner, it could have done so regardless of the contentions of counsel, for the City Bank participated in the fraud.

The United States Supreme Court held that the receiver could not recover the amount of the credit. In the opinion, written by Mr. Justice Holmes, the Court said (pp. 545 ff.):

"This suit, it will be remembered, is to recover an alleged deposit, and the first thing to notice is that *the whole business, from beginning to end, was, and was intended to be, a mere juggle with books and paper to deceive the examiner.*

* * * * * * * *

"As between the banks, *no one got any money; and the only benefit of the loan in fact or contemplation was a swindle upon the bank examiner.* If the City Bank should be held, it would be held without ever having received a *quid pro quo* except in the most narrowly technical sense. The consideration would be the delivery of Billingsley's note by the Guthrie Bank.

* * * * * * * *

"* * * it merely agreed to credit these sums against the notes which it held, on the express condition that no checks should be drawn against them; and that,

when the first note matured, or after the second, whenever the bank pleased, the notes should be charged against the account and extinguish it. We perceive no sufficient ground for substituting a fiction for the only promise the City Bank ever really made. If the Guthrie Bank had sued while it was a going concern, it could not have recovered, and *the receiver stands no better than the bank.*" (Italics supplied.)

The statement of facts contained in the opinion of the Supreme Court in the *Rankin* case is stated to be an abridgment of the facts more fully set forth in the opinion of the Circuit Court of Appeals, reported as *Cherry* v. *City National Bank,* 144 Fed. 587, to which express reference is made. That Court was more specific in characterizing the conduct of the City Bank:

"This method of bookkeeping no doubt served the purpose which inspired it, to deceive the comptroller or the bank examiner. The Guthrie Bank appeared to have, according to its books, at first $30,000. and later $25,000. to its general credit in the defendant [City] bank more than it really had. In this way the Guthrie Bank was able to get rid of its three obnoxious notes amounting to $30,000. apparently without disturbing its cash reserves, and in a manner satisfactory to the bank examiner. * * *" (*Cherry* v. *City National Bank,* 144 Fed. 587, 590).

"We find that the parties at *the outset agreed that the transactions in question should take the forms of loans but not their reality.* * * *" (*ibid.* pp. 590, 591).

"*The whole transaction was a subterfuge. It afforded the Guthrie Bank the spurious opportunity of making a partial and misleading entry on its own books* to the effect that it had a greater general credit in the defendant [City] bank than it really had; thereby

enabling it to take care of the excessive loans without exciting suspicion. *The correspondence shows that the defendant [City] bank became subservient to the scheme of the Guthrie Bank,* but on terms of absolute security to itself. *It* accommodated its customers, *pretended* to make a loan of money, but in reality retained possession and absolute title to the same, and by charging the face of Billingsley's notes to the special account, in the circumstances disclosed, it cannot be said to have made use of any of the money of the Guthrie Bank. The Guthrie Bank, while it was a going concern, could not have maintained an action against the defendant for conversion of the money, and neither can the receiver, who takes only the rights of the bank, now do so. But if the transaction in question evinced a real loan by the defendant bank, instead of the pretended one, as already found, we must reach the same conclusions" (*ibid.* p. 591).

"These quotations, and other features of the letters [to the City Bank] very clearly show the purpose to have the money which incidentally became available by means of the loan, the current general account and the misleading bookkeeping of the Guthrie Bank, devoted at once to the use of the Bank, and not to Billingsley's own use. The promise found in the letter of September 8th, to keep as large a general balance on hand as possible and the contemporaneous draft of $30,000. against the general account in favor of the Guthrie Bank show how the scheme was to work. The Guthrie Bank was to get out of the general account $30,000. for its manipulation in disposing of the excessive loans, and by reason of the fact that the special account, even though it could not be drawn against, was to appear in the Guthrie Bank as a part of its general balance in the defendant bank, the apparent gen-

eral balance would not be lessened thereby and the bank's reserve would apparently remain intact" (*ibid.* p. 592).

"The special finding of fact discloses that contemporaneously with the borrowing of the check for $30,000. drawn against the general account in defendant bank, the excessive loans were 'taken up or charged out of the assets of the bank'; that these notes are not now among the assets of the Guthrie Bank; that 'it does not appear what has become of them'" (*ibid.* p. 593).

"* * * *It is too clear for further argument that the notes in question were, with the full understanding of both parties,* employed by them as instrumentalities of the Guthrie Bank to do its business, and not that of Billingsley personally" (*ibid.* p. 593).

Counsel for the Receiver argued in the Circuit Court of Appeals that the reason for Mr. Justice McKenna's dissent in the *Rankin* case was his familiarity with the ruling of his own Court, the Ninth Circuit, in the case of *Pauly* v. *O'Brien,* 69 Fed. 460, which is one of the cases upon which they strongly rely here. This suggestion, if adopted, completely destroys the theory of the Master that the question of whether the receiver had greater rights than the bank was overlooked by the Supreme Court in the *Rankin* case. For if this was the reason for Mr. Justice McKenna's dissent, it follows of course that the principle declared in *Pauly* v. *O'Brien was* discussed and considered by the Court in deciding the *Rankin* case.

The four federal cases cited by the Receiver do not sustain his proposition that a receiver can recover though the bank could not:

In *Pauly* v. *O'Brien,* 69 Fed. 460 (C.C. Calif., 1895), decided thirteen years before the *Rankin* case, the Court

held that there was good consideration, the note in question having been given with the *bona fide* intention that it replace an existing bad note, and added (p. 461):

> "If, however, this was not really the case, but that, in truth, the transaction was a mere trick to make it appear to the government, and to the creditors and stockholders of the bank that it had a valuable note when in fact it had none, the result must be the same, for when parties employ legal instruments of an obligatory character for fraudulent and deceitful purposes, it is sound reason, as well as pure justice, to leave him bound who has bound himself."

There is no statement that the bank could not have recovered.

In *Federal Reserve Bank* v. *Crothers,* 289 Fed. 77 (C.C.A. 4, 1923), the Court held that the note was given, not for the accommodation of the bank, but for the accommodation of its president, intending it as a real asset, and that there was, therefore, no failure of consideration. The *Rankin* case was distinguished on this ground, and on the further ground that in that case the Guthrie bank was a party to the fraud and could not recover.

In *Bohning* v. *Caldwell,* 10 F. (2d) 298 (C.C.A. 5, 1925), directors of a national bank gave their notes to cover a shortage of assets in the bank. Their interest was held to be a sufficient consideration. There is no indication that the bank itself could not have recovered.

Utley v. *Clarke et al.,* 16 F. Supp. 435 (D.C. N.Y., 1936), the plaintiff, who was suing the receiver to recover back securities lent to the bank's officers to give a false appearance of assets, had to set out his own wrong as part of his case.

None of these cases seems to be inconsistent with the *Rankin* decision.

D.

The Receiver Cannot Recover on Account of Any Rights Derived through Creditors or Depositors of the Bank and Arising Out of Damage to Them.

1. *No Rights Arising out of Damage to Creditors and Depositors was Pleaded (nor, in Fact, do the Pleadings Allege Any Deception of the Bank Examiner).*

The Circuit Court of Appeals ruled (R. 287) that there were no allegations in the declarations at law of deception of, or injury to, any creditors of the Bank.

In his petition for rehearing the Receiver urged that, though the actions at law were on the bonds, in the suits in equity—

> "the depositors were found by the Master to have suffered loss by reason of the conduct of the agent of the Surety Company, and that, therefore, such damage can upon the pleadings and the findings of the record, be the subject of decrees in favor of the receiver" (R. 290).

The Circuit Court of Appeals denied the petition on the ground that the only issues raised by the pleadings, at law or in equity, were on the bonds (R. 292).

The pleadings must fit the proof.

> "The proofs must be according to the allegations of the parties; and if the proofs go to matters not within the allegations, the Court cannot judicially act upon them as a ground for its decision; * * *."
>
> Story, J., in *Harrison et al.* v. *Nixon,* 9 Pet. 483, 503.
>
> *C., B. & Q. R.R.* v. *Babcock,* 204 U.S. 585, 592, 593.
>
> *Wall* v. *Parrott Co.,* 244 U.S. 407, 411.
>
> *Piatt* v. *Vattier,* 9 Pet. 405, 415.
>
> *Putnam* v. *Day,* 22 Wall. 60.

Pickard v. *Clancy,* 275 Mass. 89.
Duane v. *Merchants Legal Stamp Co.,* 227 Mass. 462, 468.

"The hardships of a particular case would not justify this tribunal in prostrating the fundamental rules of a court of chancery—rules which have been established for ages, on the sound set and clearest principles of general utility. If the pleadings in the cause were to give no notice to the parties or to the court of the material facts on which the right asserted was to depend, no notice of the points to which the testimony was to be directed, and to which it was to be limited; if a new case might be made out in proof, differing from that stated in the pleadings, all will perceive the confusion and uncertainty which would attend legal proceedings and the injustice which must frequently take place. The rule that the decree must conform to the allegations, as well as to the proofs of the parties, is not only one which justice requires, but one which necessity imposes on Courts."

Marshall, C.J., in *Crockett* v. *Lee,* 7 Wheat. 522.

"If fraud is relied on it is not sufficient to make the charge in general terms" (after trial).

St. Louis & San Francisco R. Co. v. *Johnston,* 133 U.S. 566, 577.

"If, indeed, it were true in fact that the bill does not allege this incompetency so as to put it in issue, the objection would be conclusive; for it is well settled that the decree must conform to the allegations of the parties."

Marshall, C.J., in *Harding* v. *Handy,* 11 Wheat. 103, 120.

"A party is not allowed to state one case in a bill or answer, and make out a different one by proof; the *allegata* and *probata* must agree * * *."

Boone et al. v. *Chiles et al.*, 9 Pet. 177, 207.

The facts constituting the estoppel relied upon must be pleaded if relief is to be based thereon.

Rittenhouse v. *Newhardt*, 232 Pa. 433.
Appeal of Thompson, 126 Pa. 367.
Lehigh Valley R.R. v. *McFarlan*, 30 N.J. Eq. 180.
Moran v. *Palmer*, 13 Mich. 367.
21 Corpus Juris, 674, 675, Equity, § 855.

The Surety Company insisted from the outset upon its right to confine the evidence to the pleadings (R. 90).

2. *The Receiver does Not "Represent" the Creditors in Such a Way as to Enable Him to Enforce on Behalf of All the Individual Rights of One.*

The Master recognized that under the *Rankin* decision the Receiver could not hope to stand better than the Bank with respect to any rights derived *through* the Bank. He did not, therefore, waste time on rights derived through the Bank; but proceeded to look for rights derived through creditors. This fact is apparent where he says (R. 67):

"In the course of a six-page opinion Mr. Justice Holmes adverts to the receiver's status only once by saying (p. 546): 'The receiver stands no better than the bank.' This is the only reference to any *possibility that the receiver might derive rights through creditors that he did not derive from the bank;* and it raises the

suspicion that no such contention was made." (Italics supplied.)

To supply this want left by the *Rankin* decision, the Master—mindful that the state decisions seemingly at variance with the *Rankin* decision used the word "estoppel"—sought a further "estoppel" to connect the creditors with the Surety Company; and then, by an ambiguous use of the word "represent," arrived at his conclusion:

> "4. I rule that the bonds and 'endorsements' in suit are binding obligations in the hands of the Receiver *due to the fact that he represents the Bank's creditors*" (R. 42). (Italics supplied.)

The expression that the Receiver "represents the Bank's creditors" is familiar and is frequently used in the state cases. But the Master was not using it in its familiar sense and as used in those cases. He was using it, undefined, to cover (1) representation of the creditors as the custodian of assets in which they are to share ratably, (2) representation of the individual rights of individual creditors who may be shown to have been misled, and (3) any other representation convenient to the argument.

How does the Receiver represent the Bank's creditors? The phrase, undefined, might mean anything or nothing. It reminds one of Pareto's remark in his "The Mind and Society" (vol. 1, p. 352, § 586):

> "A person interested in arguments only as regards their logico-experimental force might suppose that when people are stocking up with such postulates they would see to it that they be as exact as possible and lend themselves to strictly logical development. But experience has shown that that is not the case, nor ought the fact seem surprising to anyone mindful of

the logic of sentiments. *For purposes of persuasion postulates that may mean anything because they mean nothing exact are the best imaginable.*" (Italics supplied.)

Although the language of the Master means nothing exact, and although some courts have used similar language inexactly, if we turn to the fundamental concepts of the law, to the thing itself and not just the words, the fallacy of the ruling is apparent.

> "It is claimed that the receiver represents both creditors and stockholders, and so all objections derived from either and both of these sources are put together and urged with united force, although it may happen that one of these classes will take the entire benefit of objections which only the other class can make. Views of this sort are, perhaps, encouraged by a generality of expression, in adjudged cases, which did not, in their circumstances, call for precision and accuracy."
>
> *Curtis* v. *Leavitt*, 15 N.Y. 9, 42; quoted in *Marion Trust Co., Receiver,* v. *Blish*, 170 Ind. 686; 84 N.E. 814.

There is one generally accepted sense in which a receiver "represents" creditors. A corporation, and here a national bank, is a legal entity. It owes certain duties to its stockholders, other duties to its creditors. So long as the corporation is solvent both stockholders and creditors have interests in it represented by choses in action. In a sense the corporation may be said to "represent" these interests.

The corporation as a legal entity stands between its stockholders and creditors as such, on the one hand, and the other persons with whom it has dealings, on the other hand. Nei-

ther stockholders nor creditors, as such, are parties to its transactions. It "represents" its stockholders and creditors only in the sense that it represents itself, and that they each have an interest in it, depending upon the terms of the choses in action by virtue of which each is a stockholder or creditor.

When the corporation becomes insolvent, the interests of creditors usually predominate. That they do so may be due to the difference between the kind of contract between a corporation and its stockholders and the kind of contract between the corporation and its creditors; it may be due to the insolvency or bankruptcy law; it is usually due to both. Because those contracts and those laws (at least prior to the enactment of Section 77B of the present bankruptcy law) have generally accomplished the result of wiping out the stockholder's equity when the corporation is insolvent and is being liquidated, we have come to think of the creditors as the only ones still having interests in an insolvent corporation.

Since the purpose of the liquidation is to collect the assets, to liquidate them and to distribute them ratably among the creditors, the insolvent corporation may be thought of as belonging to its creditors. (But this does not mean that the private rights of the creditors, as such, belong to the corporation.)

If the person to whom the duty of liquidation is given be given only the power to collect, liquidate and distribute the assets of the corporation among the creditors, he may be said to "represent" the creditors, in that what he is doing is for their benefit. If he is given an additional power, and is permitted to enforce the rights of individual creditors, as contrasted with the rights of the corporation which are to be enforced for the benefit of the corporation and through it for the benefit of the creditors generally, then and in that event he may still be said to "represent" creditors; but it

will not mean the same thing. And a statement of a court that a receiver "represents the corporation's creditors" cannot be understood until we understand in what sense it was intended. It is necessary, therefore, to turn from the phrase to the facts and law underlying each case.

For the purposes of orderly discussion it is convenient to take illustrations of four of the possible ways in which a receiver might—if the law permitted—"represent" creditors of the insolvent corporation of which he is receiver. These four illustrations differ in the powers enjoyed by the receiver in each case:

(*a*) The receiver might have the power and duty to collect all assets of the debtor corporation, to liquidate them, and to distribute the proceeds ratably among the creditors. Under this illustration we will assume that he stands in the shoes of the debtor and is subject to all defenses to which the debtor would be subject. In this case the receiver would "represent" the creditors only in that what he did was for their benefit, ratably but as a class.

(*b*) The receiver might have the power and duty to collect, liquidate and distribute ratably among the creditors all assets of the debtor, including assets fraudulently conveyed by the debtor or assets which the debtor for some reason could not himself recover, but which, under the Statutes of Elizabeth and like enactments, under the insolvency or bankruptcy laws, or under analogous common-law principles, could be enforced by creditors or on their behalf. To his powers might also be added a right to collect stock assessments. In this case the receiver could be said to "represent" creditors in the additional sense of enforcing on their behalf a right common to them all.

(*c*) The receiver might conceivably be given a statutory power to enforce on behalf of a particular creditor, and solely for the benefit of that creditor, a private right which that creditor had against a third person. In that event the

proceeds of his recovery would go to that creditor, and the receiver might be said to "represent" that creditor in the sense that an attorney represents his client, or a trustee his *cestui que trust,* or an agent his principal.

(*d*) But a receiver ought not under any circumstances to be empowered to enforce on behalf of all the creditors ratably a private right of a single creditor, to such an extent that the person against whom the right was enforced would be under obligation, not merely to pay the amount of the injury to that creditor, but to pay so much to the receiver that all the other creditors, none of whom had been injured, would receive the same ratable share as the single creditor who had been injured. In such a case (and it is the case which the Receiver urges), the phrase "the receiver represents the creditors" is used ambiguously, and the ambiguity covers up a fallacy in the reasoning.

If the creditors, depositors or stockholders have rights, they alone can enforce those rights.

Audenried v. *Betteley,* 5 Allen, 382.
Branch Banking & Trust Co. v. *Pierce,* 195 N.C. 717; 143 S.E. 524.
Jacobson, Receiver, v. *Allen,* 12 Fed. 454 (N.Y 1882).
Wall v. *Howard,* 194 N.C. 310; 139 S.E. 449, 450.
Simmons v. *Taylor,* 106 Tenn. 726; 63 S.W. 1123, 1126.
Bane v. *Powell,* 192 N.C. 387; 135 S.E. 118, 119.

The case of *Branch Banking & Trust Co.* v. *Pierce* (*supra*) was an action brought by the receiver of a bank against the officers and directors to recover, for the benefit of depositors and creditors, moneys and assets alleged to have been wrongfully received, negligently diverted and recklessly

squandered by them. The defendants demurred in part on the ground that no cause of action was stated in favor of the plaintiff on account of deposits alleged to have been wrongfully received. The defendants appealed from a decree overruling their demurrers, and the Court on appeal held the demurrers valid as to the assets wrongfully received. It modified and affirmed the decrees. The Court said:

> "But under *Wall* v. *Howard,* 194 N.C. 310, 139 S.E. 449, and *Bane* v. *Powell,* 192 N.C. 387, 135 S.E. 118, the allegations with respect to the wrongful receipt of deposits would seem to be without avail and superfluous in an action by the receiver. On motion they should be stricken from the complaint. *The injured depositors alone may sue for such alleged wrongs.* To this extent the demurrers are valid upon the second ground stated above."

In *Simmons* v. *Taylor* the Court said, in part:

> "The authority vested in a receiver as a matter of law, and solely by virtue of his appointment, or under a general order such as is contained in Exhibits A and B, is not to bring any sort of a suit which he may deem best or advisable, but only such necessary and proper suits as are required to assert the rights vested in him as receiver * * *. There is another class of assets which do not vest in a receiver at all, but arise out of statutory provisions in favor of creditors of a certain kind; that is, the liability of directors assenting to the creation of debts in excess of the capital stock of the corporation. This right vests only in express creditors, and not in the corporation itself, and can be sued for only by such creditors * * *."

The case of *Audenried* v. *Betteley,* 5 Allen, 382, is precisely in point. There the plaintiff had put personal property into Hammond's hands for the purpose of enabling Hammond thereby to obtain false credit and borrow money on the strength of his possession of the property. After Hammond became insolvent it was claimed that his assignee could hold the property as against the plaintiff on the ground that the latter was estopped to set up his title against a creditor who had given credit to Hammond in reliance upon the property, and that this estoppel ran to the assignee as the representative of creditors. The Court held to the contrary, and said (Hoar, J.), pp. 387, 388):

> "Each creditor who was actually defrauded may still have his action against the plaintiffs. But this right of action, which is special and individual, is not transferred to the assignee of the debtor in insolvency; and the right to treat the property which was fraudulently represented as the property of the debtor as if it were really his property, seems to us equally the personal right of the creditor who was defrauded, and not transferable by the assignment for the benefit of creditors generally."

See also *Chesbrough et al.* v. *Woodworth,* 195 Fed. 875; aff'd 244 U.S. 72.
Michelsen v. *Penney,* 10 F. Supp. 537 (*supra*).

3. The Surety Company is Not "Estopped" Because of Any Deception of the Bank Examiner or of Any Depositor or Creditor of the Bank.

The Master based squarely on *estoppel* his contention that the Surety Company was liable to the Receiver.

> "The foreseeable reliance upon these bonds of Bank examiners and creditors would *estop* the Surety Com-

> pany to deny the representations of enforceability explicit in the terms of the instruments. The cases establish that the Receiver as representative of creditors may assert the *estoppel in pais* thus arising'' (R. 65).

After citing certain state decisions which he interpreted as asserting such an ''estoppel,'' the Master attempted to distinguish the decision of this Court in the *Rankin* case by stating that in the *Rankin* case there was no evidence that the bank examiner was deceived; that any creditor relied on the situation created; that any person became a creditor after the transaction referred to; or that creditors would not be paid in full (R. 67, 68). The Receiver follows the Master's lead.

None of these elements was any more present in the cases cited by the Receiver than in the *Rankin* case. The decisions in those cases, though they use the word ''estoppel,'' appear to be based, at best for the Receiver, upon a broad public policy, making the transaction void *ab initio* by reason of the fraudulent intent without the necessity of proof of specific injury to a specific creditor. They declare the defendant makers of notes and bonds liable in an action by the receiver, because it would be contrary to public policy that the defendant, who knew the note or creditor bond was to be held out to the bank examiner as an asset of the bank, should be heard to deny that it is such an asset.

What do the additional findings relied upon by the Receiver amount to?

a. Actual proof of deception of the bank examiner would not, in itself, give the Receiver any additional rights. (It may be assumed that the bank examiner was deceived in

the *Rankin* case, since the fraud continued from September till April. The Court assumes this when it says "the only benefit of the loan *in fact* or contemplation was a swindle upon the bank examiner.") In any event deception of a public official is not in itself a ground of estoppel to deny the facts which he was led to believe.

Hunnewell v. *Duxbury,* 154 Mass. 286.

He does not represent the Government so as, through the Comptroller, to identify himself with the examiner and assert an estoppel based upon a deception of the examiner as his alter ego.

Chesbrough et al. v. *Woodworth,* 195 Fed. 875, 880 (C.C.A. 6, 1912); 244 U.S. 72.

And see *Brown* v. *Schleier,* 194 U.S. 18.
Case v. *Terrell,* 78 U.S. 199, 201.
Scott v. *Deweese,* 181 U.S. 202, 210.

If we are dealing solely with public policy, then the moment the fraudulent paper is put among a bank's assets the wrong is complete. If, an hour after the bank examiner had been deceived, the maker of the note were to repent, the situation would hardly be different from what it was when the note was originally given for the purpose of deceiving him (see cases cited at p. 48 of the Petitioner's Brief). The change, if any, must come when, by reason of action, or inaction, by the bank examiner a creditor is foreseeably led to make a deposit in the bank in reliance upon what the examiner had done in reliance upon the note. The bank examiner is, therefore, but a link in the chain of causation of injury or threatened injury to a creditor whom the receiver "represents." Bearing this causation in mind, we can turn to the case of the creditor.

b. Reliance by individual creditors cannot equitably be made the basis of an estoppel as to all.

In considering the effect of reliance upon the bonds by a specific creditor, let us assume a case in which the maker of a note, M, himself knew that it was to be shown by the bank to a prospective creditor, C; that it was so shown to C; that C, in reliance upon the belief that it was an asset of the bank, deposited or lent the bank a large sum of money; that the bank became insolvent and C lost his money. Assuming that the bank could not enforce the note against M, and assuming the decisions to be such that the receiver could not otherwise recover where the bank could not, would the facts (1) that M knew that the note was to be shown to C, and (2) that C relied on the note to his damage, give the receiver a right to enforce the note against M?

The Receiver claims that they would, because the Receiver "represents" creditors.

In the illustration we have taken we will assume, to avoid confusion, that no other creditor of the bank was misled or injured. The receiver represents all the creditors, to collect and distribute the assets of the bank ratably. Does he, in addition, represent C specifically? And if so, how?

According to the Master's ruling and the supporting argument, there is an *estoppel in pais* which "the Receiver as the representative of the creditors may assert." As representative of which creditors? The nine hundred and ninety-nine who were not injured, or the one who was?

To illustrate the necessity of this distinction, let us assume certain figures: Suppose that the total claims of creditors amount to $1,000,000; that C's claim amounts to $1000, or 1/1000 of the whole; and that M's note had a face value of $20,000. But for M's deception C would have saved his $1000, because the bank would have been closed. Assuming a 50% dividend from other assets, C has lost $500 through M's act. Conversely, M has done a wrong which

caused a $500 injury. If the receiver recovers the full $20,000 on the note, C's share will be, not $500, but 1/1000 x $20,000, or $20; M will be paying $20,000 for a $500 tort; and the other nine hundred and ninety-nine creditors will be getting $19,980 of assets to which they would not otherwise be entitled. If the receiver "represented" C, in the sense of being C's agent to collect the $500 lost by C, then he would have just the right that C would have, namely, a right of action in tort. But the receiver has no right to act for C alone. He must treat all creditors alike and distribute assets ratably.

White v. *Knox,* 111 U.S. 784; 28 L.Ed. 603.

The receiver may not "represent" the creditors in some undefined way which would let him use C's injury on behalf of all, at not only M's expense, but also at C's. Those courts which have troubled to analyze the effects of such a "representation" of creditors by a receiver have held that this cannot be done.

> "The essential question in the cases arises upon the reply, wherein the receiver, in a sense at least, shifts his ground, and attempts to fortify his original cause of action by seeking to bring forward the rights of a certain class of creditors. If the receiver were by law authorized to, and could, consistently with his duty to the general creditors, represent this limited body of creditors, it might possibly be said that he was not bound to anticipate the defense of fraud when he filed his complaint, and that therefore the reply did not involve a departure (see *United States* v. *Morris,* Fed. Cas. No. 15,816), but if it be that in filing such reply he attempts to invoke the equities of persons whose rights he in nowise represents, it is clear that the reply does not state facts in avoidance of the answer.

"* * * There can be no doubt of the proposition that it is the general rule that in the ordinary receivership, which is extended over the affairs of an insolvent corporation, the receiver can only sue in the right of the corporation, and that he is subject to all of the equities which would have been available against it. This rule is subject to the exception that the receiver so far represents the general creditors that he may *avoid* transactions in fraud of their rights."

Marion Trust Co., Receiver, v. *Blish* (Supreme Ct. of Indiana, 1908), 170 Ind. 686, 690, 691; 84 N.E. 814.

"A cause of action exists there, if at all, in favor of a *class* of creditors rather than of all the general creditors. A Receiver as trustee for creditors, may prosecute only those causes of which all the general creditors are beneficiaries. * * *"

Welliver, Receiver, v. *Coate et al.,* 65 Ind. App. 195 (1917).

"The rule has been laid down that a receiver cannot maintain an action in which the granting of the relief sought would place a creditor having an equity in a worse condition, and a creditor having no equity in a better condition, than they occupied before the receiver's appointment."

53 Corpus Juris, 325, Receivers, § 537.
Davis v. *Roach,* 83 Ind. App. 320; 145 N.E. 498.
Marion Trust Co., Receiver, v. *Blish,* 170 Ind. 686; 84 N.E. 814; 29 H.L.R. 58 (and New York and other cases cited in *Marion Trust* case).

If the Receiver is "representing" C as a creditor, in the sense that he is C's agent to enforce C's rights against M,

his right of action is not on the note, which runs to the bank. If he represents C in the same way in which he represents all the creditors, his right of action is on the note; but there is no estoppel involved.

The receiver, as such, cannot enforce an estoppel to which the obligee on whose behalf he brings suit was not a party. The bank was not party to any circumstances creating an estoppel. Nor were creditors generally.

> "An estoppel *in pais* does not operate in favor of everybody. It operates only in favor of a person who has been misled to his injury, and he only can set it up."
>
> *Ketchum* v. *Duncan*, 96 U.S. 659.
> *Campbell* v. *Nichols*, 33 N.J.L. 81.

The receiver cannot act alone for the individual creditor who alone has suffered injury.

> *Lincoln* v. *Fitch*, 42 Que. 456.

c. No individual creditor would have any right of estoppel. To return to the case supposed above, the right of the deceived creditor, C, against the maker of the note, M, would be a right of action in tort for deceit. It would be a right based, not upon the theory that the note was good, but upon the theory that it was bad (like Clark's case against the Bank, R. 70). C would have no right based upon an estoppel, because C was not a party to the note.

A stranger to a bond cannot invoke an estoppel arising therefrom.

> *Eldred* v. *Bell Tel. Co.*, 119 U.S. 513, 522.
> *Herold* v. *Jefferson*, 134 So. 104 (La. 1927).
> And see *Thompson* v. *First Natl. Bk. of Toledo*, 111 U.S. 529.

Inasmuch as C was not a party to the note, or a privy, he could not sue on the note itself, and could not enforce an estoppel in regard to it.

> "An estoppel does not create a cause of action, and plaintiff must first show that it has a right to bring this suit."
>
> *City of Pittsburgh, to Use of Bessemer Cement Corp.*, v. *Commercial Casualty Co.*, 161 Atl. 630 (Pa. 1932).
>
> *Dickerson* v. *Colgrove*, 100 U.S. 578.

The right of action of C against M would be by an action of tort, and there would be no estoppel involved with respect to the instrument to which C was not a party.

> *Linsky* v. *Exchange Trust Co.*, 260 Mass. 15, 18.

d. No creditor or depositor did rely upon these bonds to his injury.

The only creditor of the Bank as to whom specific evidence of reliance and injury was offered was Clark. Clark never saw the bonds. He heard of them, if at all, only through his son, who never saw them. Neither Clark nor his son ever knew that the name of the Standard Surety Company was on the bonds as surety. Ragan, who knew the bonds were invalid, who was an intervening fraudulent agent, and who was talking to people to whom even Cliff had not been told he would show or represent the bonds (R. 45, 47), was Forrester Clark's, and only through him if at all, Clark's source of information that these loans were secured by "surety bonds." Beyond that Clark never heard of the bonds. On the strength of this finding the Master concludes "that Clark indirectly relied upon • • • the bonds" (R. 56).

The other bases for the findings that Clark relied upon the bonds were the Comptroller's attitude toward the Bank and a published statement of the Bank. The Comptroller, the Master finds, relied directly upon the examiner's having seen the Surety Company bonds; and "Clark therefore indirectly relied upon the existence of the * * * bonds" (R. 57). As to the Bank statement, the Master finds that, though Clark relied upon it (and it made no mention of the bonds), there was no sufficient evidence to enable him to find whether or not the statement would have been different if it had been known that the loans, which the bonds purported to secure, were in fact unsecured (R. 57).

Aside from Clark, there is no evidence that any single depositor relied upon the bonds. The only evidence relied upon by the Master is that $300,000 out of the $3,000,000 owed came in after the bank examination of September, 1931 (R. 59). This adds nothing beyond what was to be fairly presumed upon the facts of the *Rankin* case. The Master is not justified in stretching the facts to fit his legal theory. His admission that he did so (R. 60) does not correct the deficiencies of proof. (The evidence appears in Exhibit H of the Report, R. 100 ff.)

If any of the new depositors was in fact deceived through fault of the Surety Company, it has not been shown; and the Receiver could not be permitted to recover, on the strength of a presumed injury, ten times the amount that would go to the injured depositors; or over twenty times, if we take the revised figures evolved in Exhibit H of the Report (R. 104, 105).

e. The Surety Company is not estopped by the power of attorney or other indicia of authority to assert, even as to any creditors who might have relied on the power, that the bonds were fraudulently obtained.

See *Deputron* v. *Young,* 134 U.S. 241, 257.

The only act of the Surety Company was to give Cliff the power of attorney. This might estop the Surety Company from denying his authority as to any one who, in good faith, entered into a transaction directly with him in reliance upon the power. That is as far as the cases go which are cited at pages 61 and 62 of the Petitioner's brief. Even if the bonds had been executed at its home office, the Surety Company could set up the fraud by which they were obtained. The power of attorney was no representation that the bonds were not obtained through fraud by the Bank.

The Bank alone entered into the transaction of the bonds; and the Bank did not receive them in good faith. The rights of creditors on the bonds themselves is merely derivative and subject to defenses available against the Bank.

2 Williston on Contracts, §§ 394, 402.

They could not sue on the bonds.

Willard v. *Wood,* 135 U.S. 309.
Saunders v. *Filley,* 12 Pick. 554.

Creditors who did not rely on the bonds can have no rights of estoppel.

Thompson v. *First Nat. Bank of Toledo,* 111 U.S. 529, 537.

Creditors and depositors who, after the execution of the bonds, relied upon them (without becoming purchasers thereof for value and without notice) must depend upon a

deception of themselves after the original transaction. And such deception can give them no right to have the bonds enforced as such by the receiver of the Bank.

Lincoln v. *Fitch*, 42 Que. 456 (*supra*), at pp. 468, 469.

Baker v. *Davie*, 211 Mass. 429, 440.

The only power Cliff received from his principal was to execute and deliver instruments in its behalf. He had no authority under the power of attorney to conspire with Ragan to deceive the bank examiner or creditors of the Bank. If he did so he was acting outside his authority and the Surety Company is not bound by his acts except to some one who has been injured by his acts, of whose injury some intent or negligence of the Surety Company was the proximate cause.

If the bonds were not in fact binding between the Surety Company and the Bank, their appearance can be no ground of an estoppel.

Bissell v. *Spring Valley*, 110 U.S. 162, 169, 170.

The Surety Company had no intent to deceive any one. Cliff's knowledge of Ragan's fraud is not imputable to it (see above, I, B, pp. 30, 31).

The Surety Company was not negligent in doing the only acts it did. The Master found (R. 54) that—

> "The Surety Company was not negligent in employing him (Cliff) or in furnishing him with the power of attorney, stationery and seal."

This is not a case like the Telegraph Company cases cited by the Master, or *Gleason* v. *Seaboard Air Line*, 278 U.S. 349, where the Surety Company owes a specific duty to the bank examiner or to prospective creditors or deposi-

tors of the Bank. The power of attorney was intended for use with persons entering into transactions with Cliff as agent for the Surety Company. It forms no basis for an estoppel as to creditors of the Bank.

Bower, Estoppel by Misrepresentation, § 232, p. 201.

National Savings Bank of D.C. v. *Ward,* 21 Wall. 138.

LeLieve v. *Gould,* L.R. [1893] 1 Q.B. 491.

Supreme Lodge of Knights v. *Johanna Benes,* 135 Ill. App. 314.

Bigelow on Estoppel (6th ed.), pp. 617, 708.

It was not a reasonable probability that Cliff would use the power to deceive a bank examiner. It could not have been so used except by the intervening fraudulent act of Ragan, the president of the Bank.

O'Herron v. *Gray,* 168 Mass. 573, 577.

This may be as good a place as any to advance another argument: While the Bank was a going concern, it, rather than the examiner, was the representative of the creditors' interests. The Master has not found when the Bank became insolvent, or that any creditor relied upon the published statements of condition (R. 58). He has not found that it was kept open because of these bonds (R. 59). (See *McDonald* v. *Chemical Nat. Bank,* 174 U.S. 610.) All that is shown is that it was insolvent when closed.

Mechanics Universal Joint Co. v. *Culhane,* 299 U.S. 51.

If, as is not shown, the Bank was insolvent, or would have appeared insolvent but for these bonds, when the bank examiner saw them, and if at that time the examiner was

acting for creditors, anything that put him upon notice with respect to the validity of the bonds must, if they rely upon him as their representative, have put them on notice. That he was put on notice seems apparent. The bonds themselves must have been most unusual. It is common knowledge that a surety company does not write guaranty bonds without full collateral; and if the obligors to the Bank had had full collateral, they would have given it to the Bank and saved the premiums on the bonds. Next, as the Master found (R. 55):

> "A careful textual examination of the Westchester bond would have raised at least a doubt as to whether it secured the $40,000 Westchester note."

In the somewhat analogous case of *Loring* v. *Brodie*, 134 Mass. 453, 467, the Court said:

> "Notice of the existence of an instrument of trust affects the party purchasing trust property with full notice of its contents, whether he chooses to examine it or not. This is conceded. He should be thus affected, not only by what appears upon the face of such instrument in terms, but by the information given by it, if such information, when made the subject of fair and reasonable examination, would show the conduct of the trustee to be such as it did not permit."

The failure of the Bank to demand payment and give notice on default were apparent. That the examiner was put upon inquiry is apparent from the fact that he made inquiry—of Cliff (R. 55). But not only were Cliff's statements as to his authority in writing the bonds outside his authority and the power of attorney; they would not even have been received as evidence of his authority in a court of law. (Corpus Juris Secundum, 276, Agency, § 322).

And there could be no ratification of his acts without full knowledge by the Surety Company. (*Combs* v. *Scott,* 12 Allen, 493, 495; *Kidder* v. *Greenman,* 283 Mass. 601, 615; and see *Angle* v. *Northwestern Ins. Co.,* 92 U.S. 330, 338, 340). Why the examiner did not make his inquiry of the home office of the Surety Company may be surmised from the fact that he had already allowed himself to be so lenient to Ragan that, when the Bank was finally closed, it had only $170,000 with which to pay $3,000,000 of liabilities, and an adverse answer to his inquiry would have been most unwelcome.

But even assuming that the creditors relied in good faith upon the power of attorney, and that they suffered injury in reliance thereon (which has not been shown), no estoppel can arise out of anything except a negligence shown to have been the proximate cause of such reliance and injury.

Western Union Tel. Co. v. *Schriver,* 141 Fed. 538.

Estoppel comes from an intention to deceive, and is enforced on grounds of negligence only where the negligence is such that the party to be estopped knew, or ought to have known, that it would be acted upon by the person or class of persons asserting the estoppel.

Stiff v. *Ashton,* 155 Mass. 130, 133.

In this case the only persons whom the Surety Company ought to have known would rely upon the power of attorney were persons who should contract with Cliff.

Liability for negligence growing out of a contract, where the negligence is not so gross as to amount to fraud, "is bounded by the contract, and is to be enforced between the parties by whom the contract is made."

Cardozo, J., in *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 189.

"But the law does not regard estoppels with favor, nor extend them beyond the requirements of the transactions in which they originate."

Tracy v. *Lincoln,* 145 Mass. 357, 360.
Huntress v. *Hanley,* 195 Mass. 236, 241.
Boston & Albany R.R. v. *Reardon,* 226 Mass. 286, 291.
Gejurgis v. *Brockton Standard Shoe Co.,* 197 N.E. 51, 53.

"Appellant also contends that the corporation should be held liable under the rule that where one of two innocent parties must suffer he who clothed the wrong doer with power to cause the injury must suffer for the loss. Appellant both misinterprets this rule and attempts to apply it in a kind of action where it is wholly inapplicable. This principle cannot be construed and applied literally * * *. The rule can be invoked only with the qualification that the words 'enabling a person to cause the loss' must be understood to mean by some act, conduct or default *in the very transaction in question.*" (Italics supplied.)

Fifth St. Bldg. & Loan Ass'n v. *Kornfeld et al.,* 315 Pa. 406 (1934).

Even if the Surety Company had been negligent in permitting Cliff to have powers of attorney which might be annexed to these bonds, it would not be liable for an injury arising out of some reliance thereon subsequent to the transaction itself, for which its negligence was not the proximate cause.

Briggs v. *Spaulding,* 141 U.S. 132, 162, 163.
Scollans v. *Rollins,* 173 Mass. 275, 281.
O'Herron v. *Gray,* 168 Mass. 573, 577.

In *Swan* v. *No. British Australian Co.*, 2 H. & C. 181 (1863), the plaintiff had delivered to a broker ten forms of transfer in blank of the stock of a company. The broker filled two of the forms with the name of another company in which the plaintiff had stock and sold the shares to bona-fide purchasers. It was held that the transfers were void, and that the plaintiff was not estopped to insist that the shares had not passed under the transfer. In the course of the opinion the Court said:

> "* * * *the neglect must be in the transaction itself,* and be the proximate cause of the leading the party into that mistake; and also, I think, that it must be the neglect of some duty that is owing to the person led into that belief * * * and not merely neglect of what would be prudent in respect to the party himself, or even of some duty owing to third persons, with whom those seeking to set up the estoppel are not privy.
>
> "It is an essential element of estoppel by conduct that the party asserting it should have relied upon the representations or admissions of the adverse party; and, if he relies upon negligence as the basis of estoppel, he must show that negligence was the proximate cause of the deceit." (Italics supplied.)

National Savings Bank of D.C. v. *Ward*, 21 Wall. 135.

Bank of Ireland v. *Trustees of Evans Charities*, 5 House of Lords Cases, 389; 2 T.R. 80 (1855).

Gajanich v. *Gregory*, 3 Pac. (2d) 389 (Cal. 1931).

21 Corpus Juris, 1129.

The doctrine of the Telegraph Company cases, even where the company has been negligent, does not apply so as to create liability to a person to whom it was not contemplated by the defendant that the message would be shown. In

Western Union Tel. Co. v. *Schriver,* 141 Fed. 538 (C.C.A. 8, 1905), the telegraph operator communicated the following message without authority of the sender:

> "To Commercial Bank,
> "Britt, Iowa.
>
> "We will honor Barnes draft for eighty nine hundred seventy two dollars.
>
> "BANK OF DENISON."

One of the plaintiffs saw this message, and in reliance upon it delivered cattle to Barnes. Neither the check which he took from Barnes nor the purchase price of the cattle was ever paid. The Court held that the telegraph company was not liable.

The Court said (at p. 549):

> "One who makes a representation owes no duty of care to tell the truth to those to whom he does not communicate it, to whom he does not anticipate that it will be communicated, and to whom a person of ordinary prudence in his situation would not have anticipated that it would be conveyed * * *. The presumption was that it was intended for and would be permitted to affect the addressee only. The plaintiffs were not mentioned in it, and it contained nothing from which a person of reasonable prudence could have anticipated that it would be communicated to them. When, therefore, the Telegraph Company delivered to the Bank of Britt, it made no representation to the plaintiff, it intended to make none, and it could not have anticipated that any would be made. A person of ordinary prudence and intelligence in its situation would not have anticipated that this telegram would be conveyed to them."

Wiser v. *Lawler,* 189 U.S. 260, 270, 271.

Supreme Lodge v. *Johanna Benes,* 135 Ill. App. 314.
Peck v. *Gurney,* L.R. 6 H.L. 377 (1873).
LeLièvе v. *Gould,* L.R. [1893] 1 Q.B. 491.
Bigelow on Estoppel (6th ed.), p. 708.

"As forcibly suggested by counsel for the defendant in error, if any creditor has been defrauded by misrepresentation of the real capital of the company he has his remedy in an action of tort against all who participated in the fraud. But the wrong done to him cannot entitle the entire body of creditors, who have not suffered from the alleged fraud, to recover of the entire body of stockholders who have taken no part in it."

Scoville v. *Thayer,* 105 U.S. 143, 151.

"It is difficult to see where the doctrine of equitable estoppel comes in here. For the application of that doctrine there must generally be some intended deception in the conduct or declarations of the party to be estopped, or such gross negligence on his part as to amount to constructive fraud, by which another has been misled to his injury. 'In all this class of cases,' says Story, 'the doctrine proceeds upon the ground of constructive fraud or of gross negligence, which in effect implies fraud. And, therefore, when the circumstances of the case repel any such inference, although there may be some degree of negligence, yet courts of equity will not grant relief. It has been accordingly laid down by a very learned judge that the cases on this subject go to this result only, that there must be positive fraud or concealment, or negligence so gross as to amount to constructive fraud.' 1 Story, Eq. 391.

To the same purport is the language of the adjudged cases."

Brant v. *Virginia Coal & Iron Co.*, 93 U.S. 326; 23 L.Ed. 927, 929.

4. *Estoppel Cannot be Used to Create a Liability without Fault.*

"The estoppel here relied upon is known as an equitable estoppel, or estoppel *in pais* * * *. This remedy is always so applied as to promote the ends of justice. *It is available only for protection, and cannot be used as a weapon of assault.*"

Dickerson v. *Colgrove*, 100 U.S. 578, 584.
Hartford Realization Co. v. *Travelers Ins. Co.*, 117 Conn. 218 (1933).
Gordon v. *Continental Casualty Co.*, 319 Pa. 555.
II Herman, Law of Estoppel, p. 925, § 798.

"106. The dangerous vagueness and seductive generality of a maxim which fixes with responsibility the mere 'facilitation,' or 'enabling of,' or the mere giving 'opportunity,' 'occasion,' or 'scope' for, a wrongful act, seems to have escaped notice for a time. It gradually, however, began to dawn on the most pronounced and vehement champions of the formula that it is much too wide to merit unqualified acceptation; for, in its plain and primary meaning, it would throw the entire loss arising from the wrongful act of the third person upon one who has been guilty of nothing but unbusinesslike conduct, and deprive him of his legal rights for no other reason than that he has carelessly conducted his own affairs."

Bower, Estoppel, § 6, The "Facilitation" Theory, pp. 89, 90, 91, 92.

(For a discussion of *Young* v. *Grote*, 4 Bing. 253 (1827), see 31 Harvard Law Review, pp. 779 ff.; and Gray, C.J., in *Greenfield Savings Bank* v. *Stowell*, 123 Mass. 196, 199-203.)

> "But the law of England does not go to that extent: it does not consider that what a man writes on paper is like a gun or other dangerous instrument • • •."
>
> *LeLievre* v. *Gould*, L.R. [1893] 1 Q.B. 491 (*supra*), at p. 502.

These bonds were obtained through fraud upon the Surety Company, and it is entitled to have them delivered up and cancelled.

> *Oppenheimer* v. *Harriman National Bank*, 301 U.S. 206.
>
> *Rankin, Receiver*, v. *Emigh*, 218 U.S. 27.
>
> *Williams* v. *United States*, 138 U.S. 514, 517.

II.

The Receiver has Already Elected to Proceed to Judgment and Recovery in Another Action on the Claim that These Bonds were "Fraudulent and Uncollectible," and is Bound by That Election.

It is apparent (R. 81-88) that, whatever other claims the Receiver may have had against the Fidelity & Deposit Company of Maryland, and whatever other bases of claim he may have had against it in regard to the Westchester, Stone, Robinson and Cronin matters, he asserted claims against the Fidelity & Deposit Company based upon the invalidity and uncollectibility of the four fraudulent bonds on which he is here seeking recovery. He asserted to the Fidelity & Deposit Company in his letter of April 28, 1932, and under oath in his proof of claim of June 2, 1932, that those bonds were fraudulent and uncollectible. He brought his action in the District Court against the Fidelity & Deposit Company on that claim. He allowed that action to go to judgment in his favor in the amount of $100,000, without having withdrawn that claim. The agreement of compromise, drafted during the pendency of these suits, though ingeniously worded, provided for a full discharge of the Fidelity & Deposit Company on the Receiver's claim based on the invalidity and uncollectibility of these bonds. Having obtained his $100,000 judgment with the aid of that claim, he now seeks to recover from the Surety Company on the contrary assertion that the bonds are valid and collectible.

This, we submit, he cannot be allowed to do.

A.

A Man who has Followed One Contention Through to Judgment in His Favor Cannot Thereafter Recover in Another Proceeding Based upon a Contrary Contention.

"A remedy based on the theory of the affirmance of a contract or other transaction is inconsistent with a remedy arising out of the same facts and based on the theory of the disaffirmance, or rescission so that the election of either is an abandonment of the other."

20 Corpus Juris, Election of Remedies, § 10, p. 14.

"A man cannot say at one time that a transaction is valid, and thereby obtain some advantage to which he could only be entitled on the footing that it is valid, and at another time say it is void for the purpose of securing some further advantage."

Honyman, J., *Smith* v. *Baker* (1887), 19 Q.B.D. 347.

"If [the party electing] has done—whether he intended it or not—an unequivocal act, i.e., an act which would be justifiable if he had elected one way, and would not have been justifiable if he had elected the other, the fact of his having done that unequivocal act to the knowledge of the persons concerned is an election."

Lord Blackburn, *Scarf* v. *Jardine* (1882), 7 App. Cas. 345.

"A man shall not be permitted to blow hot and cold with reference to the same transaction, or to insist at different times on the truth of each of two conflicting allegations, according to the promptings of his private interests."

Kaehler v. *Dobberpuhl*, 60 Wis. 256.

The doctrine is well established in our courts.

United States v. *Oregon Lumber Co.*, 260 U.S. 290; 67 L. Ed. 261.
Robb v. *Vos*, 155 U.S. 13, 43.
Minneapolis National Bank v. *Liberty National Bank*, 72 F. (2d) 434, 436.
Frisch v. *Wells*, 200 Mass. 429.
Washburn v. *Great Western Ins. Co.*, 114 Mass. 175.
Counihan v. *Thompson*, 111 Mass. 270, 272.
Barnes v. *Peck*, 283 Mass. 618, 623.
Sexton v. *Prendergast*, 277 Mass. 118.
Terry et al. v. *Munger*, 121 N.Y. 161.

B.

The Receiver is No Less Bound because the Action in which he has Gone to Judgment was against the Fidelity & Deposit Company and Not against the Surety Company.

"When a party has ground to bring separate actions *against different persons*, and the maintenance of one necessitates the allegation of a fact, or the assumption of a position, inconsistent with, or repugnant to, the maintenance of another, he is bound by his election, and cannot proceed against the other."

20 Corpus Juris, Election of Remedies, § 12, p. 17.
In re Weissner, 116 Fed. 68.
Scarf v. *Jardine*, *supra* (1882), 7 App. Cas. 345.
Rewits & DeBuke v. *Uhlenhopp*, 149 Iowa, 284; 128 N.W. 400.
Hand v. *Brown*, 144 Ga. 272; 86 S.E. 1080.
Frisch v. *Wells*, *supra*, 200 Mass. 429, 430.

C.

It Makes No Difference that the Action against the Fidelity & Deposit Company was Brought After the Actions against the Surety Company.

The Receiver's proof of claim against the Fidelity & Deposit Company was filed before any action was brought against the Surety Company. This claim he pressed to judgment, with knowledge of the facts.

> "Where the defendant permits the subsequent action to be prosecuted to judgment it will operate as a bar to further prosecution of the first suit."
>
> 20 Corpus Juris, Election of Remedies, § 25, p. 35.
>
> *Scarf* v. *Jardine, supra* (1882), 7 App. Cas. 345.
>
> *Saco Brick Co.* v. *J. P. Eustis Mfg. Co.*, 207 Mass. 312, 316.

D.

The Fact that the Judgment in the Receiver's Action against the Fidelity & Deposit Company was Entered by Agreement does Not Relieve him of the Consequences of that Judgment.

If the Receiver had placed no reliance whatever on his claims that the fraudulent bonds here in question were uncollectible, he might have formally withdrawn those claims before the entry of the judgment. The facts that these bonds were specifically mentioned in the collateral agreement, that the Receiver's claims based upon them were included in the release, and that the Receiver had that agreement and release impounded are sufficient indication that this was not due to an oversight. The truth is apparent: That he continued to rely upon these claims until he had obtained his judgment against the Fidelity & Deposit Com-

pany. Having done so, and having got his $100,000, he cannot now claim that that general judgment does not cover these claims.

> "The compromise and settlement of a suit constitutes such an election as will preclude plaintiff from thereafter prosecuting an action based upon a theory inconsistent with that on which the former action was maintained."
>
> 20 Corpus Juris, Election of Remedies, § 16, p. 21.
>
> *McClellan* v. *McClellan,* 135 Ga. 95; 68 S.E. 1025.

The judgment in the Receiver's action against the Fidelity & Deposit Company, though entered by consent, was a satisfaction of all the claims made by the Receiver in that case.

> "For it was not necessary to show specifically for what items the jury returned their verdict, or whether they allowed anything on account of the cause of action which is declared or in the present action, because without any such particular proof the payment would be held to be conclusive upon the parties in relation to all matters which were in issue between them upon the trial."
>
> *Sargent* v. *Fitzpatrick,* 4 Gray, 511, 513, 514.

> "If that judgment had been founded on a verdict of a jury or a finding of a judge, there could be no question that it would be a bar to the present action on the doctrine of *res judicata.* On reason that doctrine is equally applicable to a judgment such as here was shown entered by consent in an action at law. It was for a substantial sum. It was an adjudication and settled finally the rights of the parties to that cause of action."
>
> *Biggio* v. *Magee,* 272 Mass. 185, 187.

E.

The Receiver having Gone to Judgment in his Action against the Fidelity & Deposit Company, it is Not Necessary for the Surety Company to Show that his Claims against the Fidelity & Deposit Company, Based on the Fraudulent Bonds, were in Fact Legally Enforceable against the Fidelity & Deposit Company.

In no cases found has the party setting up such a bar as here pleaded been required to try the former case. There are cases in which the plaintiff, having failed to recover in another action, has been held not to be barred. But these are cases in which he has mistaken his first remedy. Where he has gone to judgment in his favor in the other action, he is bound.

Even where the Court has held that a compromise settlement out of court was not a bar, the Court has said that a judgment would be conclusive.

> "Beyond question, if, assuming the action were tried, the plaintiff had been so ill-advised as to take a verdict and judgment upon the count of money had and received, that would have been a conclusive election on his part to waive the tort, and he could not thereafter have maintained this action against the present defendant."
>
> *Rice* v. *Reed,* [1900] 1 Q.B. 54, 62.

And where the plaintiff with knowledge of the defenses in one action has pressed that action to judgment, even though it be a judgment against him, he cannot thereafter prosecute an inconsistent remedy.

> *United States* v. *Oregon Lumber Co.,* 260 U.S. 290, 297; 67 L. Ed. 261, 269.

This is not a case in which the enforcement of the bar will deprive the party barred from all recovery on either of his

inconsistent claims; he has had one recovery. It is not a case in which the bar would operate merely as a defense protecting a party who has been guilty of wrong-doing. The Surety Company has been guilty of no wrong-doing. Nor is it a case where the defense is merely technical: The Receiver has come into court once relying upon a proof of claim, under oath, that these bonds were fraudulent, invalid and uncollectible. He has maintained that contention in the District Court as a basis of recovery. He has maintained it although he knew that the Surety Company was a re-insurer on the bonds on which he was seeking recovery by that claim, and would presumably be required to pay its share of any amount recovered by him on the basis of that claim. He has maintained it up to judgment on that claim. He has used it for what it would bring against the Fidelity & Deposit Company. And he has obtained a judgment of $100,000, which has been satisfied. He then came into the same Court, and, in effect, said to the Court: "Now that I've got that $100,000, I want to change my position and claim that these bonds are valid and enforceable, so that I can get some more money from the Standard Surety Company, even though they may have paid part of the previous judgment which I obtained on my claim to the contrary." If the action against the Fidelity & Deposit Company had been tried with the cases at bar, the Court would have required the Receiver to elect—or would have held that he had already elected by his proof of claim. And, quite aside from any possibility of double recovery from the Surety Company, the Court would have refused there, and should refuse here, to let a party recover both on the claim that the bonds were uncollectible and on the contrary claim that they were collectible. Such conduct is unconscionable.

III.

Any Right of Recovery on the Bonds which Might have Existed was Lost Through Failure to Give Notice of Default.

A.

The Right of Recovery on the Bonds was Conditioned on Notice of Default in Accordance with Their Terms.

All of the bonds contain the provision that in the event of non-payment by the principal of the debt purported to be secured, the Bank "shall notify the Home Office of the Surety Company * * * within 10 days by registered mail, of such default."

The Master has ruled (R. 73):

> "9. I rule that the giving of notice of default within ten days was not a condition precedent to recovery under any of these bonds and that, there being no evidence of damage to the Company from such delay as may have existed, the Company has no defense based upon the requirement of notice."

It is submitted that such notice is a condition.

> "If the words purport to be those of a party who is not to do the act they are interpreted, unless a contrary intention has been manifested, as limiting the promise of that party by making performance of the act a condition."

Restatement of the Law of Contracts, § 260.
Fitchburg Savings Bank v. *Mass. Bonding &c. Co.*, 274 Mass. 135.
McCord v. *Masonic Casualty Co.*, 201 Mass. 473.
McCarthy v. *Rendle*, 230 Mass. 35.
Eastern R.R. v. *Relief Ins. Co.*, 98 Mass. 420.

Smith v. *Haverhill Mutual Fire Ins. Co.*, 1 Allen, 297.

Suzuki et al. v. *National Surety Co.*, 290 Fed. 942 (C.C.A. 2, 1923).

The Master attempts to distinguish the cases cited above from the case at bar by stating that "common forms of insurance policies have been held to make notice a condition precedent to the bringing of an action; but the language of such policies differs substantially from that of the instruments here in suit." Four of the above cases are actions upon policies of insurance. But the case of *Fitchburg Savings Bank* v. *Massachusetts Bonding &c. Co.*, 274 Mass. 135, is an action on a "blanket" indemnity bond. The instrument declared upon in each case provided for notice in case of loss, and the Massachusetts Court has uniformly held that failure to comply with this provision constitutes a breach of condition and bars recovery.

The Master goes on to say (R. 75):

> "The instruments in those cases [the five cases above cited] seem to me distinguishable from those in the case at bar in their uniform insistence upon satisfaction of the requirement of notice as a prerequisite to the bringing of suit."

But an examination of those authorities discloses that in most of the cases *the instrument itself* does not require a satisfaction of the requirement of notice as a prerequisite to the bringing of suit; rather, the denial of recovery is based upon the Court's ruling, as a matter of law, upon the facts in each case, that failure to give the notice constitutes a breach of condition.

The Master cited numerous authorities in support of his contention that the requirement of notice is merely

promissory unless it is expressly made a condition or ground of forfeiture. All of the cases thus cited, with the exception of the case of *New Amsterdam Casualty Co.* v. *United States Shipping Board,* 16 F. (2d) 847 (C.C.A. 4), appear to be actions upon standard policies of insurance of different states. In the *New Amsterdam Casualty Co.* case, although the Court held that failure to give the notice required by the particular bond in that suit did not constitute a breach of condition, there appears the following statement:

> "We have carefully considered the authorities relied on by defendant * * *. They told that *failure to give notice of default in accordance with the terms of a condition contained in a fidelity or indemnity bond releases the surety from further liability thereunder. There can be no doubt that such is the law.* In these cases notice of default was provided as a condition of liability doubtless because the liability of the surety was contingent upon the bad faith or breach of contract of the principal, which would be exclusively within the knowledge of the obligee, and, if there was to be a claim of liability, the surety desired prompt notice so that it might investigate the circumstances upon which the liability was to depend."

It is submitted that the bonds in suit, if they were contracts at all, would be contracts made in Massachusetts, and that the law of the Commonwealth prevails upon all questions of construction.

In the case of *Community Bldg. Co.* v. *Maryland Casualty Co.,* 8 F. (2d) 678 (certiorari denied, 270 U.S. 652), which was an action upon a contractor's bond, originally brought in the state court and removed to the federal court upon the question of diversity of citizenship, one of the questions before the Court concerned the liability of the casualty com-

pany where the insured failed to give notice of a breach of condition of the bond. The Court said:

> "In determining the rights of litigants arising out of a contract of suretyship such as this, made and to be performed in the State of Washington, a federal court should follow the rule established by the highest court of that State."

See also in this connection—

> *Lubriko* v. *Wyman*, 290 Fed. 12.
> *Sturtevant Co.* v. *Fidelity &c. Co.*, 285 Fed. 367.
> *Burgess* v. *Seligman*, 107 U.S. 20; 27 L. Ed. 359.

> "A guaranty is to be construed strictly, and the defendant is entitled to rely upon its precise terms; to charge him with liability thereon the plaintiffs must prove that its conditions have been fully complied with."

> *Davis* v. *Wells*, 254 Mass. 118, 125.
> See *Warren* v. *Lyons*, 152 Mass. 310, 312.

The notice had to be given to the *Home Office;* notice to an agent would not be sufficient.

> "Notice to a person, particularly notice to a person at a specified place, is not given until it reaches the person named at the place specified."

> *McCord* v. *Masonic Casualty Co.*, 201 Mass. 473, 475.

Nothing that Cliff did, or could do, would deprive the Surety Company of the right to insist upon the performance of this condition. An agent had no right to waive the requirement of notice. No authority short of the Home Office,

which was entitled to receive the notice, could waive it. A waiver from an agent would be no more effective than notice to an agent.

Walsh v. *Hartford Fire Ins. Co.*, 73 N.Y. 5.

And nothing said or done by the Home Office without knowledge of its rights would constitute a waiver.

Boston Elevated Ry. v. *Maryland Casualty Co.*, 232 Mass. 246, 252.

Even if a note was "renewed," and the bond covered the renewal, the surety company was entitled to notice of non-payment of the first note on its due date. The requirement of notice of default is for the protection of the surety company. Having a bond which covers renewals, the bank is relieved of any necessity to inquire into the circumstances of the maker when he comes to renew it. But the purpose of notice of default is to put the guarantor in the same position which the bank would have been in without the guaranty, and to give the guarantor the right to exercise his own judgment in considering whether or not payment of the note should be insisted upon when it comes due or should be postponed to a later date.

Lascelles v. *Clark*, 204 Mass. 362, 373.

Upon receiving notice of non-payment the surety company might well prefer to pay the note itself, taking over the obligation of the maker, who was then able to pay, rather than take the risk of having the note extended for another period at the end of which the maker might not be able to pay.

Chace v. *Brooks*, 5 Cush. 43, 50, 51.

This is an important right, which is secured by the condition that the obligee shall give notice of non-payment. The

condition applies to each maturity date, however many times the original note may be renewed. Failure to give the notice deprives the surety company of the protection to which it is entitled, and prevents the obligee from recovering.

Shepard & Morse Lumber Co. v. *Eldridge,* 171 Mass. 516, 533.

The Master's ruling was based in part on his assumption that the Surety Company suffered no damage through delay in giving notice. But Cronin's first note matured on September 22, 1930 (R. 76). Obviously a notice to the Home Office of the Surety Company at that time would have prevented the writing of all three of the subsequent Westchester, Stone and Robinson bonds, given by Cliff under dates of December 20, 1930, June 2, 1931, and July 8, 1931, respectively. In like manner notice of each default would have prevented bonds being written subsequently. In the case of the Cronin "renewals" "sometimes there was an interval between the maturity of the old note and the making of the new, the longest such interval being sixty-three days" (R. 78). Want of notice of such defaults would have damaged the Surety Company if it were to be held liable on the bonds.

B.

The Bank did Not Give Notice as Required on the Cronin Bond.

This bond was dated September 6, 1930. The condition was that Cronin should pay *within six months from September 6, 1930,* his note for $20,000 due September 22, 1930, "or any extension thereof." On default of such payment the Bank was to notify the Home Office within ten days. No notice was given until November 4, 1932 (R. 76-78).

The original Cronin note matured September 22, 1930. Even the six months mentioned in the bond expired on March 6, 1931. Not having paid the note on September 22, he was in default. Even on the Master's interpretation of the bond, he was in default by March 6. Of default the Surety Company was entitled to notice at its Home Office within ten days. It did not receive such notice. Not having received it by March 16, the Surety Company was clearly discharged from liability. At that time neither the Stone nor the Robinson bond had been given.

Three "endorsements" were signed by Cliff. The first was dated March 21, 1931 (fifteen days after default), the second May 21, 1931, and the third November 2, 1931.

These "endorsements" cannot have the effect of waivers. The failure to give notice could not be waived except through the Home Office, which was entitled to the notice. Attempted waiver by an agent, even in express terms, without full knowledge of the Home Office, would not bind the Company.

The requirement that the Home Office was to be notified was equivalent to a provision that no other notice would suffice. A waiver of the required notice, therefore, must come from the same source. A waiver is the voluntary relinquishment of a known right. It must be shown that the Company at its Home Office knew that it had a right, before it can be found to have waived it.

> *Boston Elevated Ry.* v. *Maryland Casualty Co.*, 232 Mass. 246, 252.
>
> *Schwartz* v. *American Surety Co.*, 231 Mass. 490, 494.
>
> *National Constr. Co.* v. *Travelers Ins. Co.*, 176 Mass. 121, 123.

And no act or conduct of any agent, without such knowledge, would waive the company's rights.

Moreover—still ignoring any question of fraud in writing the bond originally—even if Cliff had authority to waive notice and if the endorsements can be construed as waivers, if he executed them in complicity with Ragan for the independent fraudulent purpose of concealing the default from his principal, his knowledge of the default could not be imputed to the Surety Company, which could disaffirm his act as soon as it became known.

Innerarity v. *Merchants National Bank,* 139 Mass. 332, 333.
Allen v. *South Boston R.R.,* 150 Mass. 200, 206.

Even if we disregard the condition in the bond for payment *within six months from September 6, 1930,* and even if the requirement had been to give notice of default of payment of any note, there were many defaults on the Cronin notes, of which no notice was given (R. 78).

Even conceding the "endorsements" to be everything that can possibly be claimed for them as extensions, the Surety Company was entitled to notice of each one of the defaults. It makes no difference whether the new notes were renewals or not, or whether as matter of law or fact notes given from one to sixty-three days after a prior note had not been paid can be said to be renewals. The terms of the bond cannot be ignored, and failure to give the required notice after each one of the many defaults discharged the Surety Company.

The Master ruled (R. 77, 78), that the "endorsements" extended the time of default to November 3, 1932, and that the time within which notice was required to be given did not expire until five days from that date, irrespective of when the notes which the bond purported to secure became due and went into default. This ruling was wrong. Even if the endorsements were new contracts, as the Master ruled, they are not complete in themselves, but must incor-

porate the terms of the bond as originally written. The endorsement did no more than extend the time limit of the bond from March 6, 1931, to November 3, 1932, and shorten the time of notice from ten to five days. But the "default of the principal" referred to was default in payment of his note to the Bank, just as it was in the bond. Granted that the bond covered renewals of the original note, as the Master rules, yet if the original note had not been renewed, notice of the default to pay it must have been given within ten days after such default. The Bank could not wait from September 22, 1930, to March 16, 1931, without giving notice to the Surety Company that the note had not been paid. This would not be fair to the Surety Company and would not give it the protection which was clearly intended, namely, to have prompt notice of the default of the principal's obligation, which was, of course, to pay his notes on their due dates.

If a note was renewed, then the obligation of the principal was thereby postponed, and within the limit of time prescribed in the bond the obligation of the Surety Company continued, and there would be no default of which it was entitled to notice, until the renewal note became due and was not paid. But when a renewal was not made on the due date, and the maker of the note had not by a renewal postponed his obligation to the Bank, he was in default of his obligation and the Surety Company was entitled to notice. His failure to pay his note when it became due, or to prevent a default by getting it extended, was clearly the "default on the part of the principal" referred to in the bond.

Cronin's so-called renewal notes were often given after the default. The last note became due on January 4, 1932. He defaulted payment on that date. No notice of his default was given until November 4, 1932. This failure to give notice discharged the bond (R. 79).

It is submitted that the construction placed upon the notice requirement by the Master cannot fairly be given to the words of the bond.

C.

The Bank did Not Give Notice as Required on the Westchester Bond.

This bond was dated December 20, 1930. The bond does not purport to secure the payment of the $40,000 note of the Westchester Company, but is conditioned on the payment *upon their due dates* of four other notes, each for $10,000 due, respectively, on January 20, February 20, March 20 and April 20, 1931. In default of the payment of *any* of these notes, the Home Office of the Surety Company was to be notified within ten days.

There is no definite evidence in the case to show what these four notes were or what has become of them. They may never have existed; they may have been paid; they may have been cancelled; they may have been surrendered; or they may have been renewed. Without clear evidence to show what the notes were, or that they in fact existed, and what became of them, the plaintiff cannot recover on this bond. The evidence fully warranted the Master's ruling that there was no liability on the Westchester bond. The "(4) notes signed by Legion Parkway Realty Corp. val. $40,000" are described as collateral in the $40,000 Westchester note itself. The pencil memorandum of dates on the note, however, do not correspond with the dates of the notes referred to in the bond.

But whatever the notes were, and even if they have not been paid, no sufficient notice of default of their payment has ever been given. The notice given December 31, 1931, did not refer to the four notes described in the bond, but to the default of the Westchester Company "to pay *their*

obligation bonded by your Company." This is not sufficiently accurate.

Torrey v. *Adams*, 254 Mass. 22, 25, 26.

Moreover, the notice was not in time. The first "endorsement" on this bond was dated April 20, 1931. The second was dated June 20, 1931. Clearly these endoresements, if effective at all, would only extend the bond as to any liability the Surety Company was under at the time when the endorsements were made. They could not revive obligations from which the Surety Company had already been discharged. On April 20, 1931, the failure of the Bank to notify the Home Office of the non-payment of the three notes, whatever they were, falling due before that date, had by then relieved the Surety Company of all liability upon them. The only liability which then could have been left was the note maturing on that day. The endorsement of April 20, if it had any effect, did not alter the condition of the bond, and as to the note falling due on April 20, the Bank was still required to give notice of non-payment within ten days. The condition of the bond was that the Westchester Company should pay the notes listed *on their due dates*, and that the Bank should notify the Home Office of default of payment of any note. The Surety Company had a right to know whether this note, as well as any other, had been paid on its due date, even if the "endorsement" obligated the Surety Company for two months longer. The bond itself stipulated that the Surety Company should pay within thirty days after April 20, 1931. Even if the endorsement extended this thirty days to December 30, there was no change in the obligation of the Bank to give notice of the default of payment of any note upon its due date.

Furthermore, neither of the "endorsements" will support an action, for the reason that they were given without consideration. They are not waivers; they are, if anything,

new contracts. They modified the bond in the important respects of term, amount and notice. The suit is brought upon them, and not on the original bond, which is only evidence to supply the terms of the endorsements.

Epstein v. *Northwestern Nat'l Ins. Co.*, 267 Mass. 571, 574.
Mill Dam Foundery v. *Hovey*, 21 Pick. 417, 429.
Blasdell v. *Souther*, 6 Gray, 149, 151.

They were all made after the notes referred to in the bond had been given, and therefore required a new and independent consideration.

Stone v. *White*, 8 Gray, 589, 593.
Mecorney v. *Stanley*, 8 Cush. 85, 87.
Tenney v. *Prince*, 4 Pick. 385, 387.
B. & R. Brewing Co. v. *Motycka*, 163 Ill. App. 238, 240.

The endorsements are not under seal, and the consideration imported by the seal on the bond does not support them. They are not within the classes of cases stated in *Torrey* v. *Adams*, 254 Mass. 22, 26, and the recognized limits of these cases is not to be extended.

Parrot v. *Mexican Central Ry.*, 207 Mass. 184, 185.

D.

Notice on the Stone and Robinson Bonds was Not Given as Required.

The Stone Bond:

This bond purported to secure the payment by Stone of his obligation to the Bank of $52,000 *within one year from June 2, 1931.* Stone had owed the Bank this amount for

some time before that date. In event of Stone's failure to pay his indebtedness within the year, notice was required to be given to the Home Office of the Surety Company within ten days. There were no endorsements on this bond.

No notice was sent to the Home Office of the Surety Company until *June 30, 1932.* This was too late by eighteen days (R. 80), and there can be no recovery.

The Robinson Bond:

The condition here was that the maker should pay his note *within four months* from July 8, 1931, "or any extension thereof." The words "or any extension thereof" do not prolong the four months within which the note must be paid. Whether the note was extended or not, non-payment on or before November 8 was a default of the condition of the bond, notice of which must be given to the Surety Company. The requirement of notice of default is absolute. Whatever may be the meaning of the obscure words which follow in the bond, the default, of which notice must be given within ten days, is non-payment within four months. Whether, if such notice had been given, the bond would continue in force is immaterial. The Master finds the bond ambiguous and therefore disregards "four months from date hereof" as repugnant. To us the words "or any extension thereof" are just as repugnant.

The letter of November 12 was not notice of a default. It merely asked the Surety Company's assent to another arrangement of the note. (In this connection note the inconsistency between the letter, which asks consent to a course proposed by the Bank on November 12, and the books of the Bank, which showed that a new note for $19,000 was taken on the same day (R. 81). The Bank could not have relied on any reply from the Surety Company even had the letter been sent.)

Even if the letter could be construed as a notice of default, it was not given to the Home Office, as required by the terms of the bond. It never reached the Home Office, and was not even mailed to that address. It was diverted by Ragan, in the Bank, through no fault of the Surety Company. Responsibility for this diversion and the consequent failure to give notice must rest upon the Bank, and not upon the Surety Company. Nor was the reply of November 17, dictated by Ragan, a waiver of notice. It did not come from the Home Office. A waiver from any source other than the Home Office cannot be relied on, without showing that it was in fact authorized by the Home Office with full knowledge of the Company's rights. It could not have been relied on by the Bank, because the new note had already been accepted on November 12.

See *Boston Elevated Ry.* v. *Maryland Casualty Co.*, 232 Mass. 246, 253.

On November 8 the Robinson note was not paid, and the bond was in default. This default continued (even on the Bank's theory that a new note given after the maturity of another is a renewal) until November 12, when another note for $19,000 was given, maturing December 9, 1931. This later note was not paid. Yet no notice of either of the defaults was sent to the Surety Company until July 8, 1932. These failures to perform the conditions of the bond discharged the Surety Company.

Conclusion.

Counsel for the Surety Company respectfully contend that no enunciation of the principles which should govern cases between receivers of national banks and persons who participated in deception of a bank examiner is essential to an adjudication of the rights of the parties to these actions. The Receiver is asking the Court to enforce against an innocent surety company, itself engaged in a business charged with a public interest and subject to governmental examination and regulation, instruments fraudulently obtained and never included in *its* reported liabilities upon true reports of which the insuring public depends for *its* solvency. The Receiver is asking the Court to enforce, as valid, instruments on whose invalidity he has already based action, judgment and recovery on blanket bonds against an insurer for which this respondent is a re-insurer. The respondent has the further defense of default of notice on the bonds. As an individual litigant it asks the protection of the Court.

Respectfully submitted,

FREDERIC H. CHASE,
RAYMOND P. BALDWIN.

Frank H. Stewart,
Of Counsel.